UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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GEOFFREY OSBERG,

Plaintiff,

v. 07 Civ. 1358(KBF)

FOOT LOCKER, INC. et al.,

Defendants.

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New York, N.Y.
July 23, 2015
9:00 a.m.

Before:

HON. KATHERINE B. FORREST

District Judge

APPEARANCES

GOTTESDIENER LAW FIRM, PLLC
Attorneys for Plaintiff
BY: ELI GOTTESDIENER
STEVEN COHEN
ALBERT HUANG

PROSKAUER ROSE LLP
Attorneys for Defendants
BY: MYRON D. RUMELD
ROBERT RACHAL
JOSEPH E. CLARK

ALSO PRESENT:
Jon Int-Hout, Trial Technology Specialist
Randall Carter, Trial Technology Consultant

(Trial resumed)

(In open court; case called)

THE COURT: Good morning all of you. We are going to get into the testimony of Mr. Sher in just a moment, but let me ask, I had previewed last night dealing with the letter motion by the plaintiffs to preclude and/or strike certain aspects of his testimony.

Except in one respect, which is minor, I am going to deny the motion for the following reasons:

One, I checked back on the docket and didn't find any *Daubert* motion that had been made previously, which would normally be the way in which one would raise issues as to reliability, expertise, and things of that nature.

It is frankly difficult to do it on the fly in 24 hours, and the better course here is to allow the testimony, and the Court will sort out that which is appropriate from that which is inappropriate.

I am not going to rely upon anything that is irrelevant, and anything that is beyond Mr. Sher's expertise is subject to cross-examination, if there is anything that falls into that category.

In terms of relevance, there are a number of relevance objections. If we look at the second page of the plaintiff's letter, which is on ECF at 368, it's the 7/22 letter, there are various ways in which these statements are in fact

objectionable, and I agree with that. However, it is also the case that these statements can be associated with points which are relevant and are important to this case.

For instance, whether or not -- to take the first bullet point -- the cash balance plan saves money or always saves money, is designed to save money or only saves money with wear-away is an important point to understand if that is one of the items that would be captured within that first bullet point.

As to the second bullet point, that really just sets the background. I don't think that the sustainability of the retirement program is in and of itself a core issue here except as to overall intent. Ultimately it's the intent as to the communication of the full details of the plan and/or of the benefits that is most relevant. When I say full detail I don't mean every comma, I mean every major material aspect of the plan relevant to a participant, so I see that point as background.

As to the third point, which is if the cash balance plan had not been adopted it's likely that another cost-saving course would have been taken, that is truly something which the Court would ignore, but I take that simply as self-evident in a way in which a company which doesn't save costs in one manner might save costs in another manner. I wouldn't expect that that is a place where Mr. Sher would spend any time.

The remaining issues that are in the bullet points really go to what I'm going to call intent.

Now, there are different standards which you folks argue are applicable to intent. I think if the plaintiffs are correct, largely some of this would become irrelevant. If the defendants were correct, then some of this would be potentially indicative of circumstantial evidence as to good faith and intent in that manner.

So I am not going to essentially give a ruling at this point that would determine that issue. I am obviously thinking a great deal about all legal issues, and among them are the various legal standards applicable.

The remaining issues are really subject to cross-examination, including the points relating to the 9 percent etc.

So that's as to the content.

As to the attachments, I have been through them carefully. I can't really tell what all of them are relating to.

MR. RACHAL: Your Honor?

THE COURT: Yes. You have solved it?

MR. RACHAL: I think I solved it, or we solved a piece of it. The draft of my response letter messed the response on that. Those attachments are not his slides. I don't know what they are. The attachments to Mr. Gottesdiener's letter are not

Mr. Sher's files. They are something else. I don't know what they are. Those are not his slides.

THE COURT: 368-1 is the ECF attachment that I had that were indicated as his slides.

MR. RACHAL: Right.

THE COURT: If they are not his slides, so be it. The only one I thought was something I was going to preclude was the first page. The rest of it I couldn't tell what it was aimed for, but that is neither here nor there. If they are not his slides, we won't see them.

MR. RACHAL: You may see them from plaintiff later.

THE COURT: So be it.

With that said, let's go ahead and commence.

Mr. Rachal, would you like to call the defendant's next witness.

MR. RACHAL: Yes. Mr. Sher.

THE COURT: Mr. Sher, please take the stand.

MR. RACHAL: Your Honor, would you like a copy of the demonstratives.

THE COURT: Have you given the actual demonstratives to the plaintiffs?

MR. RACHAL: Yes. We have resolved most of the objections. There are still a few we have left. I don't know if you want to do that now or as we go through the testimony. We have most of them resolved, but not all of them.

THE COURT: I would rather deal with things at the outset than have testimony interrupted.

MR. RACHAL: OK.

THE COURT: Why don't you give me a set. Why don't you folks tell me --

MR. GOTTESDIENER: Your Honor, I might suggest, I think the defense might agree that we are narrowing, and the ones that remain that will be disputes I think the Court would benefit from briefly hearing the dispute after having heard some of Mr. Sher so you would have a real feel and you would be able to rule really quickly, because right now we would have to start --

THE COURT: Right.

MR. GOTTESDIENER: -- educating the Court as to which position they have.

THE COURT: I think that is fine with me, if that's the better way to proceed in light of what you folks know about the slides.

MR. GOTTESDIENER: We also have a lot of ground to cover.

THE COURT: Yes.

MR. RACHAL: Two things I would say, your Honor. We resolved some of the objections. Just so Mr. Gottesdiener knows, what we just provided the Court has the adjustments or changes we made in light of the discussion, so that set has

that, and the one that will pop up on the screen should have that.

I absolutely agree. A lot of these objections may get mooted once seen in the context of Mr. Sher's testimony. Mr. Gottesdiener may decide it's not objectionable.

I had some of that happen with some of Mr. Deutsch's slides. Sometimes you are not sure what they are being used for. One purpose may be OK; another purpose maybe not.

THE COURT: Let's do it this way.

I have been handed a set of slides which bear consecutive numbers 1 through 13. I haven't checked to see if every page is there, but I am going to assume that I have 34 pages.

Is that right, Mr. Rachal?

MR. RACHAL: Yes.

THE COURT: 34 slides.

MR. RACHAL: It should be 405 to 435, and there's one slide, DX 434. I thought I would give you a heads-up that we are proceeding to resolve the objection. We are not there yet, but we may be able to resolve it over lunchtime.

THE COURT: The slides are also numbered in the bottom left with DX numbers, with DX 405 running consecutively through DX 435.

Thank you. Let's go ahead and swear the witness.

LAWRENCE SHER,

called as a witness by the Defendant,

having been duly sworn, testified as follows:

THE COURT: Mr. Sher, please be seated. I am sure you understand how important it is that you speak slowly and clearly into the mic.

THE WITNESS: Yes.

THE COURT: Thank you.

MR. RACHAL: Your Honor, do you want me to bring up the reports that he's swearing to, a copy?

THE COURT: Do you have a set? Does he have a set in front of him?

MR. RACHAL: The witness has a set. Does the Court want a set.?

THE COURT: No. I've certainly got a set.

MR. RACHAL: OK.

THE COURT: Mr. Sher --

MR. RACHAL: One other thing. I hate to interrupt.

THE COURT: Yes.

MR. RACHAL: One other housekeeping thing.

We withdrew one of his reports. There is a back and forth in the letter. We don't have any objection to it being in the record. We withdrew it because it is not going to be pertinent to his testimony.

THE COURT: All right. You had said you don't have any problem having it in. Does the plaintiff want it in? We

are happy to keep it in then.

MR. GOTTESDIENER: Yes, your Honor.

THE COURT: All right. So Mr. Sher, how are yours numbered? Mine are numbered 15A through D. But will you look and see whether or not --

MR. RACHAL: I have it.

Those will match up.

I can tell you just, so we are sure we are on the same page, we have it as DX 12, which I think is 15 --

THE COURT: DX 12, DX 401, DX 14, and DX 400, correct?

MR. RACHAL: Yes. That's the DX numbers I have, which I think correlate to 15A through D. They are the same report. One we had withdrawn, but we are fine keeping them in the record.

THE COURT: Mr. Sher, can you confirm that those are, in fact, your expert reports which you intend to offer as a portion of your direct testimony in this matter?

THE WITNESS: I can on three of them. The one that had been withdrawn I don't think is in front of me, but if it's what I think it is, I certainly can.

THE COURT: All right. We will get a copy of it at some point and put it in front of him so that he can confirm that.

Do you swear to the truth of the contents of those declarations and those reports?

THE WITNESS: I do.

THE COURT: All right. Thank you.

You may proceed, Mr. Rachal.

DIRECT EXAMINATION

BY MR. RACHAL:

MR. RACHAL: Your Honor, briefly I am going to touch upon Mr. Sher's background that we believe that is particularly pertinent to the issues in his testimony here in the case.

BY MR. RACHAL:

Q. Mr. Sher, were you a member of A standard settings board for the actuarial profession?

A. Yes. For six years I was a member of the Actuarial Standards Board, which is a board that provides actuarial standards of practice for all actuaries in the U.S.

Q. Have you ever advised employers and others on cash balance plans and conversions?

A. Yes. On many occasions, both in terms of my own clients, as chief actuary at the firms, at firms that I worked at, I advised as sort of the go-to person on cash balance issues. So I advised employers who were clients of some of my colleagues. I have also advised government officials at both private meetings and at public hearings.

Q. Have you conducted any research projects or made any presentations on cash balance plans?

A. To start with the presentations, I have made numerous

presentations at various actuarial and industry meetings over the years.

What was the other one?

Q. Oh. You conducted a research project?

A. Oh, research, yes. I conducted, I was basically in charge of a survey that was actually attached I believe to my first report when I was at PWC back in 2000.

It was a survey of 100 plans that are converted from a traditional defined benefit plan to a cash balance plan. Also did a follow-up study four years later when the group I was with was acquired by Mellon, Mellon Bank, and in various other research projects over the years involving cash balance plans.

THE COURT: Let me just ask a question since you have raised the survey.

Was Woolworth a participant in that survey?

THE WITNESS: Your Honor, I don't know. Certainly I don't know at this point, and I may never have known, because one of the things that we tried to do was keep the names of the companies sort of off on the side. When we publish a survey, one of the stipulations in trying to get companies to agree to participate was that their names would not be revealed.

THE COURT: All right. Thank you.

THE WITNESS: You're welcome.

BY MR. RACHAL:

Q. Finally, Mr. Sher, did you testify as an expert in the

Amara v. Cigna case?
A. Yes, I did.

MR. RACHAL: Jon, if you would pull up DX 405.

This is just an overview of the topics that Mr. Sher will be addressing in his testimony. The first topic we are going to go to is whether wear-away had dual aspects from a benefit and cost perspective.

What is your opinion, Mr. Sher, on whether wear-away had dual aspects from a cost perspective?
A. OK. I think what you mean, and correct me if I'm wrong, but certainly there would be normal cost savings with respect to individuals while they are in wear-away. Those benefits are not being added at that point so that the normal cost for them would be zero until they get out of it.

On the other hand, when people take lump sums, particularly in those early years, interest rates had come down quite a bit and stayed down for the most part.

Every time somebody took a lump sum -- and there were loads of people who did so in all three years, '96, '97, '98, but focusing on '96 for a minute, when people took lump sums invariably there was a loss to the plan because of the favorable rates that those lump sums were being cashed out at, at 6 percent discount or something close to 6 percent, rather than the rate of return that the actuary was assuming, which was 9 percent. So that differential caused a significant

increase in company cost.

THE COURT: Let me ask, and I don't want to bog us down too much in things you are going to get into in substantial detail later, but does the unfunded liability also take a decrease if a lump sum is paid out?

THE WITNESS: No, your Honor. Actually it increases when a lump sum is paid out. What happens is the assets decrease --

THE COURT: I understand that.

THE WITNESS: -- exactly as to what is paid out, but the liabilities don't decrease by as much because the plan is holding a smaller liability with respect to an individual who is paid out because the liability is being discounted at 9 percent.

So the liability is smaller versus the assets that are paid out. So what happens is both numbers come down, but the assets come down by more than the liabilities, and you get an increase in the unfunded liability, and then that has to be amortized, kind of like a mortgage, to make up for the deficit over time.

THE COURT: All right.

We'll get into that, I'm sure, more.

MR. RACHAL: Yes.

THE COURT: You may proceed.

BY MR. RACHAL:

Q. I am going to go first to the normal cost part of this evaluation.

Just for the record, Mr. Sher, what are normal costs?

A. It is an actuarial term. I will try to describe it pretty simply. At least in this situation the actuary was Mercer, they were using a particular methodology where the normal cost under that methodology is very simply increase in the benefit that each individual has under the plan the present value, the cost to provide that increased benefit during the ensuing year. So a normal cost is an amount determined for a given year.

Q. Based on your review of the documents from Mercer, did you see any expected reduction in normal cost related to wear-away?

A. Yes, I did.

Q. What did Mercer's cost analysis to Foot Locker show on normal cost savings between the first and subsequent years?

A. I think what they showed is expected normal cost in the first year and then they showed ongoing years. And, of course, there is a differential. The savings in the first year is greater, so the normal cost is expected to come down compared to the prior plan by more in the first year than in subsequent years.

Q. Was it your interpretation and understanding that that difference between the first year normal cost and the ongoing normal cost was related to wear-away?

A. Yes.

THE COURT: Is wear-away a necessary feature of the cash balance plan?

THE WITNESS: No, your Honor.

There are a variety of ways you can design a cash balance plan.

If the objective is to set up opening balances so that all of the individuals' benefits, both the future ones, which are the pay credits added in, as well as the benefits attributable to past service are expressed in the new paradigm, that is, in terms of an account, once you have opening balances, at least in the situations that I have looked at, been involved in over the years, almost invariably there is a chance of there being a wear-away at some point in time, sometimes initially, sometimes maybe not initially. But down the road, especially when interest rates fall, even plans that have no wear-away up front could end up with wear-away just because interest rates have come down and the value of the prior benefit has gone up, whereas the cash balance is just going up nice and steadily.

MR. GOTTESDIENER: I want to lodge an objection, your Honor, because your Honor's question --

THE COURT: That is OK. I felt like I got an answer to it. I did.

So overruled. It is actually in the nature of a motion to strike. Overruled and denied.

Thank you.

THE WITNESS: You're welcome.

BY MR. RACHAL:

Q. What was your interpretation based on Mercer's breaking out the normal cost to Foot Locker on the first year versus ongoing in relation to what it meant on wear-away, potential wear-away savings?

MR. GOTTESDIENER: Objection.

THE COURT: Overruled.

A. Well, my interpretation was that Mercer anticipated that the bulk of the normal cost savings would be in the first year. Otherwise, I would have expected -- you know certainly this is what I would have done -- I would have expected them to show a pattern of decreasing normal costs. So I guess my interpretation was, is that it must not have been significant, the difference between the second year, what they thought the second year normal cost was and what they showed as ongoing that it was significant they would have shown it.

MR. RACHAL: Jon, would you pull up the Kiley notes, Exhibit PX 129, the first page, and highlight the third paragraph, the whole third paragraph, beginning with the 5 -- yes.

BY MR. RACHAL:

Q. I'm going to read this and then I have a question for you.

The $5,625,000 is a onetime normal cost. This is

because of GATT, which requires a minimum interest of 8 percent. We calculate at 9 percent. So in first year you get credit for wear-away.

My first question is, and this is dated March of '95, is what was the spread when they were designing the plan in this period between the GATT rate and the discount rate used for the initial account balance?

MR. GOTTESDIENER: Objection.

THE COURT: Overruled.

A. Well, the reference to 8 percent, to GATT, GATT basically is legislation in the mid '90s, I think it was '94, that it was a trade -- the General Agreement on Tariffs and Trade is what it stands for, the acronym.

Part of that is, as is typically the case, some bill like that gets some pension changes associated with it, and what that did was it changed the interest rate basis and introduced a mortality table for the first time into Section 417(e). Previously the rates were another basis so-called, as I think Mr. Deutsch explained, the Pension Benefit Guarantee Corporation rates.

So 8 percent is about where the 30-year government bond rates, the new basis at the time were at in the early -- in early 1995. I think the rate at the end of '95 was 7.87 percent. So that was, I took that as -- it's about 8 percent.

So the differential between that rate and the 9

percent rate which is used to determine opening balances is 1 percent.

THE COURT: Let me ask, is it possible --

MR. RACHAL: I'm sorry. We do have a quick -- go ahead, your Honor, ask your question and we have a correction.

THE COURT: Is it feasible to design a conversion from a career average plan to a cash balance plan which does not save significant cost to the company?

In other words, can cost saving an embedded feature in a cash balance plan, or is it something which may or may not accompany a cash balance plan, at least at the outset?

THE WITNESS: I think there are many design elements which go into the cash balance plan. Certainly, there are ways to design a cash balance plan to produce pretty much whatever level of cost you want, higher, lower, about the same.

Opening balances can be determined in a variety of ways. As a matter of fact, they don't even have to be based on the prior plan accrued benefit. I have seen that, not often, but sometimes.

The pay credits, you know, what the scale looks like, the level of the pay credits and the scale, opening balance enhancements, other features there, are just so many varieties of features that these plans can have that you can pretty well dial in, you know, what you want in terms of cost.

THE COURT: All right. Thank you.

You may proceed.

BY MR. RACHAL:

Q. Mr. Sher, when you said that the 30-year treasury rate was about 7.87 percent, I think your testimony was that it was, at the end of '95 was at --

A. Whoops, '94.

Q. End of '94?

A. It was the rate for December '94. I got my years mixed up. Sorry.

Q. OK. Thank you.

How do you interpret what Mercer is telling Mr. Kiley about how long to expect the normal cost savings from wear-away based upon his notes?

MR. GOTTESDIENER: Objection.

THE COURT: Sustained. We don't need him to interpret the notes. You can ask him questions about one year of cost savings, something of that nature. But interpreting the notes I think is not necessary.

MR. RACHAL: All right.

BY MR. RACHAL:

Q. In these notes, I think you have PX 129 before you, did you see any other reference to cost savings from wear-away other than this reference here, the one that is highlighted, that third paragraph?

A. I will take a minute to look through it.

Q. Yes, you may.
A. No.
Q. Is Kiley's notes on the normal cost savings here related to wear-away consistent with the later normal cost analysis done by Mercer? When I talk about later later, in '95.
MR. GOTTESDIENER: Objection.
THE COURT: Overruled.
A. When you say consistent, in terms of -- I am not sure.
Q. Either amount or period of time in which we have the savings or both.
A. OK. In the later cost illustrations or estimates that I saw -- I think I indicated this already -- there was a first-year normal cost, and I think it was termed ongoing normal cost.
I believe that the differential between the two was in the $5 million range.
Q. I am going to turn now to lump sums. In your rebuttal report, did you analyze the cost of a lump sums to Foot Locker?
A. Yes, I did.
Q. You may have already touched upon this, Mr. Sher, but can you briefly explain why lump sums had costs to the Foot Locker plan. I'm assuming that a participant was in wear-away for this question.
A. Immediately before electing a lump sum, the plan is holding a liability for an individual which is based on the plan being

able to earn on the assets that are backing that liability a 9 percent per year rate.

There are also various other assumptions that are made in terms of retirement ages and when people are going to leave, how long they are going to live and so forth.

Once a person elects a lump sum, if the lump sum is determined by discounting those future annuity payments that the lump sum is replacing at a rate that is below the 9 percent investment return rate, as I illustrated before, what happens is you get an inflated, relative to the liability you are holding, an inflated amount of assets that are being paid out, but you are only losing the liability based on the 9 percent discount rate, so the plan incurs a loss when that occurs.

MR. RACHAL: Jon, would you pull up DX 406.

BY MR. RACHAL:

Q. What does this slide illustrate, Mr. Sher. Would you --

A. OK. This is a hypothetical example for an employee age 45 on December 31, 1995. So just before the conversion date with a $10,000 accrual annual age 65 annuity.

So it is an annual benefit that is accrued as of the conversion -- just before the conversion date payable as age 65.

It is the present value of that at the valuation -- and the valuation rate that the actuary was using at 9 percent -- gets you the $13,959 number, which is shown down at

age 45.

Then the line as it's going up shows you the effect of 9 percent interest on that, so you see after 20 years, at age 65, the number is increased by a factor just because of interest accrual on it, increased by a factor of about 5 or a little bit more than 5, between 5 and 6, getting up to the $78,232.

And then the other number that is shown here in red of $29,721, all that is, is taking that $10,000 accrued benefit at age 65 and converting it to a lump sum at the lump sum rate that was then in effect for 1996, the first rate that applied of 6.06 percent, and that gets you a present value of $29,721.

So that difference is -- when I talked about a loss before, it's that difference that, for this example, it is a hypothetical example, but it's not too different than might be the case for a lot of people, this relationship would be similar for a 45-year-old at least.

Q. If in this example --

THE COURT: Can I just ask?

MR. RACHAL: Sure.

THE COURT: The assets that are needed to provide the annuity come out of the assets existing within the plan, is that correct?

THE WITNESS: Either existing, or, if there is an unfunded liability, there will be additional contributions put

into the plan to cover any unfunded liability, but ultimately they will be paid from the assets of the plan. That's right.

THE COURT: Let's just take the examples that occurred in connection with the Woolworth plan and the payments of the lump sums in the '96 to '97 time frame, just that time frame for the moment.

Was it your understanding that the lump sums were being paid out of existing plan assets?

THE WITNESS: Well, yes.

I mean --

THE COURT: So they wouldn't coming out of ongoing corporate cash flow, for instance?

THE WITNESS: That's correct. The payments are coming out of existing assets as long as there are assets.

THE COURT: And there were?

THE WITNESS: There were, yes.

THE COURT: Sufficient to cover those lump sums?

THE WITNESS: Yes.

THE COURT: You may proceed.

MR. RACHAL: Thank you, your Honor.

BY MR. RACHAL:

Q. If the 417(e) rate for example had dropped down a percent, say to about 5 percent, what would happen to the minimum lump sum that would be paid out in this example?

A. It would increase.

Q. Conversely if the 417(e) rate rose and came back up to about 8 percent, what would happen to the value of that minimum lump sum paid out?
A. It would drop.
Q. Have you seen actual examples of this lump sum cost to Foot Locker?
A. Yes, I have.
Q. Was Ms. Lerew an example?
A. She is.
MR. RACHAL: Jon, go ahead and pull up DX 407.
Q. So when did Ms. Lerew terminate and take her lump sum distribution?
A. They terminated on January 4 of '96 and took a lump sum on February 1, '96.
Q. What does the blue bar show?
A. The blue bar shows her opening balance, which was -- you can see up at the top was $9,129, with interest added to it. It's interest in this case only for one month, because you see at the bottom it says account balance as of 2/1/96. It was brought forward with the 6 percent interest crediting rate for one month, about a half a percent.
That gets you to $9,175.
Then there was a $20 pay credit for whatever she earned during those three or four days up until January 4. So then you see the total is $9,195.

Q. What does the green bar show?
A. The green bar shows, it's the actual lump sum paid on 2/1/96, $22,693. It is was determined as the present value of the frozen accrued benefit at the 6.06 discount rate with mortality as well.
Q. What does the gray bar show?
A. OK. The gray bar is my attempt at estimating what Mercer would have calculated as the liability in their actuarial valuation on behalf of Lorie Lerew. I have actually done that in two pieces here.

The number at the bottom, where I actually give a range to it between $10,000 and $13,000 -- let me just say the reason I gave it a range is because I'm not sure based on the summary that Mercer provided of their processes and assumptions in how they did their calculations, I am not sure how they handled a certain thing which I will describe in a minute.

But it is essentially the $10,000 to $13,000 is also discounted at 9 percent, like the opening balance was, but the reason it's higher than in the blue line, the $10,000 to $13,000, is because in the valuation Mercer did reflect and did anticipate the possibility of individuals ultimately being entitled to and electing early retirement benefits, which would have some subsidy.

We heard this discussion the other day in terms of subsidized early retirement benefits. So the plan does make an

allowance for that. It's not clear to me exactly how they do it, particularly if somebody leaves say at age 40.

So they make assumptions that at every age going forward that someone might leave the company. They might die, they might terminate, ultimately they might retire, or they might continue to work until some later age, 65, or they even have an assumption of people retiring at late as 70.

So that is all built into the model. For the people who are assumed the probability, the portion of each person, if you will, that is assumed to retire at early retirement age, or start their benefits at early retirement age, they have an allowance for that built in.

So that's why the $10,000 to $13,000, I am not sure how they do it for people particularly who leave before, you know, before early retirement age, whether they assume they are going to retire all at age 55 or they are assuming they will retire at 65 or something in between. That's why I gave that a range.

The $17,030, I've added in what I thought was the full early retirement subsidy. I'm saying OK, now, once Ms. Lerew actually terminated on January 4, '96, if Mercer now let's say knew that this person was going to terminate or they get information that she actually terminated and they wanted to value the most valuable early retirement benefit at that point in time, they would say, OK, let's assume that Ms. Lerew is

going to take her benefit at age 55. What is the present value of the benefit that she would be entitled to, the annuity benefit at age 55 reduced for early commencement using the more favorable rate. That works out to be $17,030.

Actually, I built in -- I have reflected the fact, even though we usually use mortality when we pay lump sums, by law they have to be based on a unisex mortality table. We can't can pay males and females different lump sums by law. But in this case, I have actually anticipated -- I knew that she was female. I said, well, Mercer would for purposes of their valuation assume, treat her as a female and come up with a slightly larger number, so that's the $17,030.

Q. Is it correct that is your estimation of the highest cost that would be associated with Ms. Lerew if she maximized her early retirement benefit by waiting until age 55 and then commencing payment at that age?

A. Yes. Based on -- again, it is all based on the assumptions that Mercer is making that the money would sit in the plan, she wouldn't have to be paid until 55 and earn 9 percent each year and then continue to earn 9 percent as long as there's still money on her behalf still in the plan.

THE COURT: But the $17,000 that you are showing there in the gray box is a number that does not equate to a cash balance account number that Ms. Lerew in this example would have direct access to at any point in time, is that right?

THE WITNESS: So if she left -- I guess we are talking about if she left her money in the plan, rather than taking a lump sum?

THE COURT: No. Let me do it differently.

The way I look at these numbers is I look at the $9,000 and I say OK that's her opening cash balance.

THE WITNESS: Right.

THE COURT: As of I guess whatever the date was, 2/1/96.

Then I look at the green piece and I see that that's $22,600, and that's the lump sum. So that is the accrued account balance as of 12/31/95.

Am I distinguishing those two correctly, valued as of 2/1/96?

THE WITNESS: It is the accrued annuity benefit that she had as of the end of '95 converted to a lump sum, so she was entitled to that. By law she was entitled to, you know, that amount.

THE COURT: Right.

THE WITNESS: That's the frozen accrued -- the frozen -- we call it the protected lump sum value.

THE COURT: All right.

The point really is that the lump sum that we have been talking about which relates to the prior plan is the $22,600.

Right?

THE WITNESS: That's right.

THE COURT: And the $9,175 is her opening account balance valued as of 2/96, correct.

THE WITNESS: That's right.

THE COURT: I just don't get what the 17 is in terms of -- Ms. Lerew is -- if she retires on February 1, '96, the $17,000 is irrelevant to her, though it may have relevance to some calculations the company keeps internally relating to potential costs and/or savings regarding her.

Is the $17,000 relevant to her personally?

THE WITNESS: It's relevant in the sense if she didn't, if she did not take the lump sum of $22,693 and instead decided to wait it out, and then when she becomes age 55, which at that point she would be able to then elect from that point forward, age 55 under the terms of the plan, either an annuity or a lump sum, and that would be, OK, if she took an annuity at that point in time, that is what the -- today the $17,000, at February 1, '96, that's how much money would be needed in the plan to fund that benefit.

THE COURT: All right. I think I get it.

THE WITNESS: OK. So you don't need any less than what was paid out, the $22,693. The plan would only need $17,030 if she decided to wait it out and take that annuity at the most valuable age.

THE COURT: All right. So this chart really shows me the amounts that the plan needs to have given certain scenarios?

THE WITNESS: I would say that's correct.

THE COURT: All right.

Then I understand the chart. Thank you.

MR. RACHAL: I have I think just one or two final questions to wrap this up.

BY MR. RACHAL:

Q. Under these assumptions, is it correct that what the plan paid out in lump sum to Ms. Lerew costed more than it would have cost the plan had she even taken the maximum early retirement subsidy? Again, this is under the assumption the plan is going to earn 9 percent.

A. Assuming the plan is going to earn 9 percent and other assumptions which aren't as important in terms of how long she'll live, yes, that's true.

THE COURT: Just bear with me for a little bit.

THE WITNESS: Sure.

THE COURT: Because I am not an actuary. I am not a specialist in any kind of pension plan designs.

What I am trying to figure out is if, I am a corporate executive, I am a CEO of a company and I am looking at my entire pension plan and I've got a big chunk of it that's funded and I am happy about that, and I have a chunk of it

that's unfunded and that worries me for a variety of reasons -- are you with me so far.

THE WITNESS: Absolutely.

THE COURT: I know I have this large population of U.S.-based employees who have qualified for some amount of participation in that plan.

If I know that, number one, I am going to do a lot of layoffs and close a lot of facilities, I will be able to predict that my plan participation is going to go down, right, just as a matter of math?

THE WITNESS: Right.

THE COURT: I may have to pay out or give employees, if I make a choice to have a cash balance plan or a lump sum option even without a cash balance plan, the ability to take funds from the plan, right?

THE WITNESS: Right.

THE COURT: But ultimately I would think that there would be a way of managing my unfunded liability. That's really what I'm getting at. That between employee attrition, changing the cash balance formula to differ from the career average formula to result in a slower rate of accrual, I would think the combination of factors with a really good actuary like Mercer would be able to project for me that my unfunded liability is going to squeeze down at least some, even if I am paying out in the short term. Is that the kind of thing you

would advise people on? Am I in the ballpark?

THE WITNESS: Yes.

I think what we as actuaries, what we tend to do is, when we are in a situation like this, is do -- at least in my practice I would make estimates and projections and look at different scenarios in terms of, OK, what happens if a bunch of people get laid off, which seemed like a pretty reasonable assumption to make at the time, how would these numbers be affected by that?

The actuary is kind of in an awkward position. Sitting there at January 1, you're supposed to sort of look, do a snapshot as of the beginning of the year when you are evaluating where the plan, what the funded status is as of that date, what the normal cost is, the total cost is for the following year.

An interesting question is, you know, should they be making some type of special assumption that there are going to be an extraordinary number of people laid off.

Usually what happens is announcements like that, there is a hesitancy for a public company to announce to its actuary information that is not in the public domain. So the actuary would almost certainly use the regular assumptions that people are going to terminate in accordance with their regular normal type assumptions, not anything extraordinary until it actually happens or it becomes public that it's going to happen.

So, on the other hand, the actuary behind the scenes should at least, I would at least make some forecasts as to how these numbers are going to look.

What this shows -- and this is not a unique situation for 1996, there were a lot of people that had numbers that looked very much like this -- is that as a result of all of these people leaving, and if they leave they're likely to take a lump sum. This is both because generally when a lump sum is offered even when people are not being laid off, just a normal course of events when lump sums are offered invariably the substantial majority of people take them.

In this situation one would think that might even be more the case. People are being laid off, they need money, they are trying to find another job. It becomes almost a severance-type benefit.

Now, that's going to cost.

So we look at it and say, well, that's going to increase the unfunded liability of the plan to the extent of --

(Continued on next page)

THE COURT: $5,000.00?

THE WITNESS: Like that for each person. I think Mr. Deutsch calculated an amount which he got from the actual report, something like $20 million is his number just for 1996, that loss.

Yes, the plan is incurring a loss and we have to make that money up over time, not have to take it up right away, they can amortize it more over time. In the meantime, they're saving all this money, as I think you alluded to in payroll costs.

THE COURT: Right.

THE WITNESS: These people for the most part are not going to be replaced. When you lay off people in this number, you're doing it because you're trying to reduce permanently your level of workforce, so the savings from all of -- not only the future pension benefits, normal costs, you wouldn't have those any more, any longer, payroll costs, you know, social security and so forth, health care costs.

THE COURT: Right.

THE WITNESS: In some cases they have to pay some of that for a while.

THE COURT: When we're talking about costs, it seems like it is appropriate to separate costs to the plan which don't come out of ongoing cash flows except to the extent there has to be a contribution to the unfunded liability at the

amortized rate, correct?

THE WITNESS: Correct.

THE COURT: Versus costs to the ongoing corporate cash flow which, in fact, could be savings?

THE WITNESS: That's right.

THE COURT: Is that right?

You could have, if you look at your balance sheet, you could have savings on one side, so Roger Farah, for instance, is looking at what this will look like for him, I will lay a bunch of people off, save me money over here, the plan, that is somebody else's problem so long as I make the annual contribution for the unfunded liability?

THE WITNESS: I'd say that's right, you know, and ultimately the idea is to save money through layoffs, not to cost it.

THE COURT: Not to cost it?

THE WITNESS: In the short run, you know, you've got the plan itself is going to incur additional costs. Normal costs would be reduced and they have the benefit. The allowable pay credits is generally lower than what they were crediting under the prayer plan. It was a long-run type of thing. Yes, the plan costs would be lower.

THE COURT: The pay credits, can we go to that one moment and the interest credits. So long as you're in wear-away on the whole, in the aggregate, if I can use that

term, so follow me for a moment because I am sure I am using the wrong terms, does the company actually have to do anything more than make a book entry as to interest and pay credits?

In other words, it calculates its total liability for the pension plan, right?

THE WITNESS: Right.

THE COURT: And it knows that its total liability is at least the lump sum value as the accrued lump sum as of 12-31-95, it is the annuity and then discounted back at the GATT rate, right? You have to at least be able to pay out a hundred percent of what people are entitled tot at 12-31-95, right?

THE WITNESS: Well, not exactly.

What they would do, what I would do in this situation as an actuary, I would make an assumption as to -- because I have to. It is not communications with employees. Now, as an actuary, I have to make an assumption. Whatever I assume it is probably going to end up being wrong, so I make some assumption as to what the 417 (e) rate is going to be in future years because this, because for any individual, in order to get a benefit, they first have to terminate, right?

Then they have to make an election. So I have assumptions as to when people will terminate and then what election they'll make. To the extent that I am reflecting the possibility that they're going to take a lump sum, for example,

I would -- and I think what Mercer did at least in the first year, they have in their valuation, I think they expressed it in maybe the '97 valuation, they assumed that a 7 percent rate, they assumed 8 percent rate which made sense, which is consistent with all of the discussions that Mercer was having, that the rate would be 8 percent, so not the 6.06.

So you can imagine what happens to that 22,693 number is you start valuing that at 8 percent, it will come down.

THE COURT: Let me ask it this way, and I am going to give him back to you. This is what happens when your witness goes last, I get to question him. I am going to hold up a piece of paper because I want to try to illustrate my question.

At the top is something called plan assets, all right? That assets include both what is actually in the account and what is unfunded. So it is meant to be total funded, unfunded liability, all right?

Let's take plan assets as of 12-31-95, okay? That is our number. Have you got that?

THE WITNESS: Yes.

THE COURT: The question I have is if the starting cash balance accounts for all plan participants are less than the aggregate plan assets as of 12-31-95, then that wouldn't take any additional contribution as of day one. Is that correct?

THE WITNESS: Well, as of day one, there is an

adjustment in that if the actuary is anticipating that this frozen accrued benefit is going to provide more than the account balance, then there would be an additional liability to cover what they anticipate that differential to be.

THE COURT: Okay. So if the frozen accrued account balance, and there is a GATT rate which might mean somehow the unfunded liabilities or the liabilities of the plan might increase a little bit based on that, there might be a need for a day one contribution, right?

THE WITNESS: Yes, that's right, depending on the level that it is --

THE COURT: So my question gets down to the interest and the pay credits that are part of the formula for the cash balance account, okay? We have that in mind?

THE WITNESS: Yes.

THE COURT: Let's just take year end 1996 to have it be easy. At year end 1996 there is a look-back for the interest at 6 percent, correct, under the new plan, correct?

THE WITNESS: There is a 6, right, 6 percent interest credit.

THE COURT: And there is also a pay credit depending upon a particular employee?

THE WITNESS: Right.

THE COURT: Now, if the amounts for interest and pay credits for all employees required at year-end 1996 along with

the cash balances for those employees is less than the aggregate plan assets as of 12-31-95, right, is it the case that you wouldn't really put the pay credits into the account? You just make a book entry? You wouldn't have to contribute new cash?

THE WITNESS: Well, because it is a defined benefit plan, the pay credits and interest rates are always just a bookkeeping amount. What has to be contributed actually dollars to the plan does depend upon the funded status of the plan, assets versus the liabilities which in this case they have unfunded liability.

The normal cost, I think in your example that gets to the $5 million number that is in the first year for a lot of people, the cash balance account is still not up to, it was anticipated not to be up to the value of the frozen accrued benefit that the actuary was valuing, would have been valuing.

Now, in this case the actuary was actually not even assuming that people would take lump sums. The actuary was assuming that people would take annuities, which further complicates it because now they have to get into a calculation of the annuity benefits.

THE COURT: That means they were calculating their costs were going to be the 17, not the 22 to the plan?

THE WITNESS: They would have calculated something probably less than that, something more like the 10 to 13 --

THE COURT: Right. Okay.

THE WITNESS: -- number. That assumes once the person leaves, after the person leaves, they meet actually, say, the person didn't take a lump sum and they actually calculated liability more like $70,000 number.

THE COURT: All right. You may proceed Mr. Rachal. Thank you for your patience.

MR. RACHAL: I have some questions that hopefully help further explain these, I hope. There this is some complicated stuff.

BY MR. RACHAL:

Q. Mr. Sher, did you review Mr. Deutsch's reports analyzing the cost of providing lump sums to participants?

A. Yes.

MR. RACHAL: Would you pull up Joint Exhibit 13 B.

THE COURT: Just so it is clear, it is costs to the plan, correct?

MR. RACHAL: Yes.

THE WITNESS: Yes.

THE COURT: Out of an existing bank account, if you will?

THE WITNESS: Yes.

THE COURT: The money has to be there, right?

THE WITNESS: That's right. The idea is to fund it in advance. You don't want to leave this until after somebody

leaves when they're receiving pension payments. It is called pre-funding. In theory, you want to get it funded up quickly as they're earning benefits.

THE COURT: Thank you.

(Off-the-record discussion)

MR. RACHAL: John, would you put up Page 22, the first paragraph that begins therefore, 3300 -- excuse me, 34 million. There we go.

THE COURT: Which report is this?

MR. RACHAL: This is a Joint Exhibit 13 B. I don't know if it has a different trial exhibit number. This is his trial report.

THE COURT: All right. 13 B.

MR. RACHAL: It is Page 22, the first paragraph, yes.

MR. GOTTESDIENER: I want to object because the way the question was asked, it was stating that it was Deutsch's analysis of the reality when, in fact, what he was doing --

THE COURT: All right. Objection to form sustained.

Why don't you re-ask.

BY MR. RACHAL:

Q. I am not sure -- let's just break it down.

I'll ask a simple question. What is Mr. Deutsch talking about here when he says, therefore, on 34,383,421 of lump-sum payments, there was a 22,915,116 loss? What is Mr. Deutsch referring to?

A. Okay. I think if you go, Mr. Deutsch did refer to the 1996 Mercer version, and he saw that approximately 53 million benefit payments were not lump sums, so he then was able to conclude that, therefore, on 34 million of lump sums, you add the 34 to the 53, you get 88.9 with an interest adjustment.

So he is concluding, therefore, he concluded based on the valuation information he saw that there was 34 million of Lump sum payments and that there was a loss of 22,915,000.

THE COURT: Mr. Rachal, could you pull that mike up a little bit because your height -- there you go. That is probably a lot better.

BY MR. RACHAL:

Q. I had a question. So what is the $11,468,305.00, what does that reflect?

A. That, I believe, is the liability of the plan with respect to the people who elect, who elected these lump sums.

So before they elected lump sums, the plan was holding a liability of 11,468,000. They paid out lump sums to those same people of 34 million. So, therefore, the plan had a loss of the difference between the two, which is 22.9 million.

That corresponds when we look at Lerew, for example, the difference between, if you will, your Honor, the second column, 10 to $13,000 type-number I believe versus the lump sum that was paid, that's the 22,9 is sort of if you add them up, of course, I approximated it in the example.

The actuary is doing this thing much more precisely. If you add it up, those differentials, you get 22.9, the difference between lump sum paid and the liability that Mercer was holding for these people.

Q. Does Mr. Deutsch's analysis appear to be reasonable here?

A. Yes, I think this ties to the fact situation here.

Q. Why would that number, the loss number be such a big number, the 22 million, almost 23 million for 1996?

A. Well, I think he adds the paying out lump sums at 6.06 percent versus what the actuary was anticipating would be earned in the plan as long as the annuity payments would have -- obviously, until the annuity payments were being made.

Q. Is it correct that during this period Mercer was assuming only annuity payments? Is that your understanding?

A. That is what is indicated in their '96 and '97 valuations at least.

Q. Do these numbers, the losses, does that reflect any savings on the early retirement subsidy by paying these lump sums?

A. Well, no. It reflects an increase in costs at least as you were discussing before, at least with respect to the plan.

They would have an increase in costs as a result of paying these lump sums that is well beyond what paying the retirement benefits might have been.

Q. What would that $23 million loss do to the unfunded liabilities of the plan, if anything?

A. Would it increase the unfunded liabilities directly by that amount.

Q. Is it my understanding the company at its option could basically pay that in over time, amortize that unfunded liability?

A. Yes.

Q. Is it correct that you reviewed Mercer's estimates to Foot Locker on the expected accrued liability, the new cash balance plan?

A. Yes, I do.

MR. RACHAL: Would you pull up PX-298, the second page, and go over to the service-based line. Would you highlight the $172 million number -- no. All the way over on the service-based. Yes, pull that up. Then pull up next, if you could, the column next to it, the title, the one that has the 100 lump sum at the top. Put those two together, that would help. There we go. Now they line up.

BY MR. RACHAL:

Q. What is your understanding that Mercer is showing Foot Locker here?

A. At least at this point in time this is April 7th of '95, they were showing them what the costs would be, estimated costs would be for -- it says service-based.

As I recall, they were discussing a bunch of different types of formulas. I don't know whether, whether this was

probably not the formula adopted but nevertheless what it shows is the costs on whatever this plan they were looking at, potential plan was.

If Mercer assumed that when people left, that everyone would take a lump sum on the one hand, the top numbers, or on the bottom half that everybody would elect annuities, so I think what this meant to me was they were showing what the sensitivity would have been of assuming it will take annuities versus everyone taking lump sums.

Q. What is the difference that we have between the 100 percent lump sum and 100 percent annuity assumption of Mercer?

A. You can see the numbers are all different. The actuarial liability which represents the benefits earned today on the lump sum side and all the numbers of the case are on the lump sum side, the numbers are higher, looking at the liability, they're already earned, 172 million versus 170 million for annuities.

Q. And then this is another example of the difference of normal costs between first year and ongoing that Mercer was selling to Foot Locker?

A. Yes, the difference, it looks like it is about 5.8 on the top and about 5.3 at the bottom, still in that $5 million range that we discussed before.

Q. I believe you said that difference would reflect expected savings on normal cost on wear-away?

A. That's what I think, yes.
Q. Why is it that there is only about a $2 million difference between accrued liabilities, the lump sums versus annuities under Mercer's analysis here, but at 22, $23 million loss appeared for lump sums in 1996?
A. I think there were at least a couple of reasons. One is that as I indicated before, I think Mercer at this point in time would not have been assuming some type of extraordinary reduction in workforce, they would be using their normal assumptions in terms of when people would leave.
If they assumed that all the people left in '96 would leave in '96, then the liability would have been 20 some-odd million higher because that would have been built into their assumptions, particularly if they assumed they were going to take lump sums. That all would have been increased the 172.
By assuming that people were going to continue to work until normally they would leave, and the other element of this is what assumption are they using in terms of the 417 (e) rate, because they're making a long-term assumption, they're not looking at each year and saying oh, '96 we know is going to be 6.06 percent, but what actuaries tend to do, they make an average assumption over the course of time.
So I believe they were assuming in these lump sum calculations that the 417 (e) rate would be 8 percent as a long-term assumption. So that, too, would tend to keep these

numbers from further inflating. If they assume that the rate would stay at 6 percent, then every time they assume that one would leave and take a lump sum, they come up with a higher benefit amount and the liability benefit amount would be higher.

Q. Is it correct that the drop in the 417 (e) rate that occurred during the plan design process continued on, increased the cost of lump sums to Foot Locker with the qualification for those in wear-away?

A. Yes, because the benefit that is really driving the numbers at that point is the frozen accrued benefit. So as long as that number is higher than the account, then that would, the fluctuation in that number coming down to 6 percent from where they were had a major effect.

THE COURT: I want to just clarify that answer.

Counsel asked you the question is it correct that the drop in the 417 (e) rate that occurred during plan design continued on and increased the cost of lump sums to Foot Locker?

Who experienced any increase in cost? Was it Foot Locker or the plan as a result of any 417 (e) adjustments?

THE WITNESS: Directly, the plan. Indirectly, of course, Foot Locker is the entity that is -- so at some point through amortization, they are going to have to pay-up that differential.

THE COURT: Have you analyzed what any annual increase in cost was to Foot Locker as distinct from the plan for lump sum payments made in connection with this plan change?

THE WITNESS: Well, take 1996, for example. You're looking at a number of --

THE COURT: I don't want you to do it now.

Have you looked at the -- what I am trying to figure out really because I want to distinguish between the costs to Foot Locker for some of these events and occurrences and the costs to the plan --

THE WITNESS: Okay.

THE COURT: -- in an immediate sense and then I understand there may be different long-term impacts, so the question for right now is have you looked at and distinguished between annual costs to Foot Locker versus annual costs to the plan for the lump sum elections which occurred post plan conversion?

THE WITNESS: Well, the lump sum elections as we indicate would affect the plan directly in terms of future, future costs.

THE COURT: My question is not are you doing -- I don't want you to do it now. Have you look at this distinction?

THE WITNESS: I looked at, I looked at just by virtue of the people leaving, not necessarily electing a lump sum, but

just leaving, Foot Locker would gain the payroll and other costs, and that doesn't matter whether they elected lump sum or not. Once they left, if not replaced, Foot Locker would have savings, payroll and health insurance and other related costs.

THE COURT: Those are cost savings?

THE WITNESS: Those are cost savings, and that is independent of whether the individual elected a lump sum or not.

THE COURT: Did the election of minimum lump-sum payments after plan conversion in the immediate period, couple of years after plan conversion, cost Foot Locker corporation any additional money apart from normal cost contributions?

THE WITNESS: Well, they saved the normal costs for these people no longer accruing benefits, but what the costs -- do you remember the annual cost the actuary would calculate would be higher than they otherwise would have been in those subsequent years right away. They would have first hit them in '97.

The '96 lump sums, the 29 million, I think those lump sums and the loss to the plan would have flowed through beginning in 1997, and the actuary would have -- all other things being equal -- there would be lower normal cost, you would have the experience of the plan for investment returns, but all other things being equal, the cost would be higher than it otherwise would have been starting in 1997.

THE COURT: Does that mean that the -- to put it differently -- did Foot Locker have to make a larger out-of-pocket payment into the plan as a result of the election of lump sums by plan participants in the years immediately following plan conversion?

THE WITNESS: I would say yes, as compared to what would have occurred had those lump sums not been elected. The answer is yes.

THE COURT: Do you know what I can look at to find that information? Is there something in the record that would reveal that to me?

THE WITNESS: Well, I don't know if it would reveal it clearly. That is one of the issues. There are actuarial reports that were produced by Mercer that identify, what they do is they identify an aggregate. They may not separate out, and Mr. Deutsch went ahead and was able to figure it out from his own from the evaluation how much was attributable to lump sums. They could have had gains from other sources like investment.

Those occurred anyhow whether people elected lump sums or not. The isolating effect of just the lump sums, the only way that I think to do it is to do the exercise Mr. Deutsch did, come up with that number and say okay, they have to put in roughly 10 percent of that amount, that loss over the next I think 15 years at the time was the period.

THE COURT: Okay. As you testify, if you talk about costs, it would be helpful for me to understand if you're talking about costs to the plan, so if there is going to be a cost incurred, whether it is a cost incurred by the plan or a cost incurred by Foot Locker, or both, or whether or not the cost is referring to cost savings, it would be useful to distinguish that as well if it ever comes up.

THE WITNESS: Okay, I will try.

THE COURT: You may proceed.

BY MR. RACHAL:

Q. Just so it is clear, is it correct, too, that the savings on normal cost is a savings to the plan, not to Foot Locker directly?

A. Well, it would be certainly a savings to the plan. I think it would be -- assuming that Foot Locker, I should think they were contributing to the plan each year, the normal cost as well as an amortization payment, then the answer is it would affect both the plan and Foot Locker. In most cases, it is going to affect both the plan and Foot Locker.

The plan considers this big loss. Foot Locker does not have to pay off that loss. They can pay it off as an amortization, so the plan is out 20 some-odd million dollars. Foot Locker has to pay it through amortization to pay down that loss over time, with interest, with interest added to it, of course, not just taking 1/15th of it as interest plus

principal.
Q. That deals with fundamental rules of ERISA that drive that?
A. Yes.
Q. Based on your review of documents related to plan cost, did the cost for lump sums for those in wear-away outweigh the savings and normal cost of wear-away at least for the '96 to '98 period?
A. Certainly for that period, yes.
THE COURT: Is that cost to whom?
MR. RACHAL: The plan.
THE COURT: The cost to?
THE WITNESS: Well, at that point it would be once these people leave the plan, it is true there would be no longer normal cost. You would say that would go on. As long as they don't replace those people, that would go on in theory indefinitely, as they would save in payroll indefinitely.
Normal costs you can deal with as a percentage of payroll. Payroll comes down because people left, their normal cost would come down as well.
THE COURT: Got it. Thank you.
MR. RACHAL: I am going to make sure I am clear on the question and answer.
BY MR. RACHAL:
Q. When I am talking about, what I am comparing is, I understand that somebody leaving, there is a savings to payroll

and plan contribution.

What I am focused on is the wear-away aspects of it to understand the costs to the plan for paying out the lump sums which we talked about earlier was greater than the savings to the plan on the normal cost that the plan achieved for people being in wear-away.

What is your answer to that question?

A. Certainly it is a lot more than the cost. The wear-away was only going to be a temporary thing. So I mean they would no longer have to deal with that, I know, with paying all the normal costs at all for these people.

The 20 some-odd million pales in comparison what their normal cost would have been.

Q. We saw a $22 million cost to the plan of lump sums for '96 and we saw an estimated five to six million savings on savings to the plan for normal cost for wear-away at least that was accepted for the the first year. I am trying to understand the relative cost to the plan for lump sums for wear-away versus normal --

THE COURT: Re-ask the question. You were so good before about being closer to the mike.

MR. RACHAL: I will. I am lost in thought.

BY MR. RACHAL:

Q. I am trying to get to an understanding of the costs to the plan for lump sums, paying lump sums for those in wear-away and

I am trying to compare that to the savings to the plan on normal costs for those in wear-away and trying to determine which is greater, and that is my question?

A. The people in wear-away who are a lot of these people, these people took lump sums, not all of them but a lot of them were in wear-away, those people were in wear-away would have little or no normal costs anyhow. So by virtue of paying the lump sums, it wouldn't affect the normal cost for them because they were in wear-away was zero or close to zero anyhow.

All you get is really that loss. You weren't expecting to pay a normal cost that year for those people anyhow.

Q. One one side we have loss to the plan for paying lump sum or wear-away. It is correct people were in wear-away, they worked in wear-away, there is a savings to the plan on normal cost?

A. There is a savings to the plan already that is anticipated.

Q. And based on your review of the facts that occurred here, which was greater, the cost to the plan on paying the lump sums while people were in wear-away or the savings to the plan from normal costs while people were in wear-away?

A. The cost of paying the lump sums.

THE COURT: Now, I think that, in fact, you folks, unsurprisingly articulate it very well the point I was so inartfully trying to make earlier with my little chart.

So let me understand what you just said, Mr. Sher. You said that normal -- I will restate it. I won't use your exact words. Tell me if I am wrong.

Normal costs for the company are zero on an annual basis for those participants in wear-away?

THE WITNESS: For those participants who are in wear-away based on all of the assumptions that the actuary is making, that is true.

THE COURT: So the normal cost that we see on various documents in the record are costs associated with the segment of participants not in wear-away. Is that correct?

THE WITNESS: I would say that's right.

THE COURT: Got it. Thank you.

MR. RACHAL: Thank your Honor.

BY MR. RACHAL:

Q. Would the cost to the plan be greater if we talk now of course '96 to '98 period under -- assume the prior plan continued forward, would the cost of the plan be greater during these mass layoffs during the period versus the cost to the plan once it was redesigned to cash balance plan. Which had the greater cost, I guess?

MR. GOTTESDIENER: Objection.

THE COURT: Hold on a second. I want to make sure I reread the question.

(Pause)

THE COURT: Can you restate the question.

MR. RACHAL: Yes, let me try it.

BY MR. RACHAL:

Q. Would the plan's cost savings on these mass layoffs, there are cost savings in the 1998, '96 to '98 period be larger under the former plan or under the converted cash balance plan?

A. So the assumption of the former plan is that all of its provisions --

Q. Continued forward?

A. -- remain just as they were before, no lump sum?

Q. Correct.

A. So when these people would have left, they would not have received a lump sum, they would have just received the annuities that they had accrued to the point that they left.

The effect, the effect would not have been dramatic, I don't think, on costs on the prior plan. There wouldn't have been this kind of loss, this $22 million loss. A $22 million loss is principally, you know, it is because of the lump sums being paid.

If lump sums had not been available, they would -- I don't see how they would experience the big loss. There might have been some -- once people left, there might be some additional chance that they'll take, you know, an early retirement benefit, get a subsidy, but not anything near the cost of paying the lump sums.

MR. GOTTESDIENER: I am going to move to strike the answer. It was speculative.

THE COURT: Denied. Denied. It based on his expertise. Whether or not the court will give it whatever weight the court deems appropriate, you can cross-examine.

You may proceed.

BY MR. RACHAL:

Q. We have a $22 million number for 1996 of lump sums because a lot of people left. Would you expect there to have been loss costs for the people who left in 1997 or 1998 to the plan who took lump sums? I assume they took lump sums?

A. I think you're asking would there be a comparable type number. For '97, the number would have been smaller at least per person. In '97 was the year that had the largest number of people leaving, I think by far. The per-person, the number I think would have been smaller.

First of all, there would be more people that were out of wear-away. Interest rates went up by about a half a percent which caused the present value frozen benefit to come down. And for some people, particularly those who had enhancement, enhancement on the balances, there may be much less differential if at all. There probably would still be some, but it would be less.

It would probably be less per-person in 1997. I haven't done the calculations. Probably the analysis that

Mr. Deutsch did for '96 could also be done, maybe he did and I am forgetting, could also be done for '97 as well.

'98, the rate came back down, if my recollection is right, the 417 (e) came back down to 6, maybe it was 5.99 or something like that, close to 6.06.

Now, if more people are, just because of accruing service, more people are out of wear-away, then at 6 percent, 5.99 percent discount rate, I would have expected a fairly hefty number for '98 as well.

Q. If the prior plan had continued forward, offered lump sum cash out, is it correct even if you had these mass terminations, the plan would still be able to have the funds in it with the expected earnings, I think still around 9 percent.

Is that correct?

A. Yes. That is essentially why I indicated that I don't think there would be a dramatic impact, anything near the 22.9 million that we saw had the plan continued because the money would just continue. Again, this is an assumption.

There is no guarantee the money will earn 9 percent, but this is what the actuary is assuming. If that assumption turns out to be right or close to right, then there would not be that kind of loss.

Q. Am I correct that assumption has consequences, though, because that determines the liabilities which under ERISA companies have to fund the plan?

A. Yes, that's fundamental to the determination of the liability and the contributions.
Q. You recall hearing Mr. Deutsch use a pipe metaphor for plan cost and benefits?
A. Yes, I recall that.
Q. How would you describe the metaphor?
A. Well, I think in order for, you know, in order for money to flow out of the pipe, which is paying people benefits, money has to come in the other side, has to flow into the pipe, which is essentially contributions from the company.
Q. Is that metaphor complete?
A. Well, he did mention, you know, at some point that there would be interest earnings on the money, the contributions that go in, they're invested, not used or needed to pay benefits at that time, you know, mount up, create the fund, they earn income.
When you're assuming a 9 percent return, you're anticipating that a large segment of the outflow from the pipe is going to be provided through income on the monies while they're in there.
MR. RACHAL: John, would you pull up DX 406 again.
BY MR. RACHAL:
Q. Does this slide illustrate that concept?
A. Yes. What this says, if you put $13,959.00 in the plan, the company would make that contribution at age 45, that you

would get about 65,000, 64,000-plus dollars of that ultimate 78,000 you have is from investment income.

A lot more of it is from investment in this situation, in this case than the contribution of 13,959 at the outset.

Q. Of course, there is growth using the actuary's assumed investment return of 9 percent?

A. Yes.

Q. Are plans typically funded substantially in advance of when the benefits are paid?

A. Yes, they are.

Q. What was the early retirement subsidy provided by the prior plan?

A. The prior plan, if somebody retired early -- the prior plan, if somebody retired early, if the individual had 15 or more years of service at the time -- and when I say "early," it is as early as age 55, the plan would make a calculation, it would reduce the normal retirement accrued benefit that the individual had to reflect the longer pay-out period, but they do it in what we call a subsidized basis.

They would reduce it. For example, some people starting benefits at age 55 with 15 years of service would get 60 percent of the accrued normal retirement benefit as an early retirement benefit. That is called a subsidy because it is worth more, on an actuarially basis, it is worth more than an actuarially basis would provide, which would be less than that.

Q. From a participant's perspective, even though it was going to flow out numbers, if you had age 65 benefit that was worth 40 percent, your subsidized benefit under the Foot Locker locker plan beginning at age 55, assuming 15 years of service, would be 300 a month. Is that correct?
A. The benefit would be 300. The subsidy is --
Q. Embedded in it?
A. -- embedded in it.
Q. The participants are going to get 300 a month at 55? At 65, they would get 500?
A. That's correct.
THE COURT: Let me understand how that is working. Someone is 49 and 362 days old or 364 days old -- 365 days in a year? Is that right?
And so either just on the cusp of turning 50, but they haven't yet turned 50, if one was to calculate based on the prior plan the annuity for that individual, one would do it pursuant to a calculation that does not include an early retirement subsidy. Is that correct?
THE WITNESS: So let me make sure I understand your Honor. This person is almost 50 as of the date they terminated?
THE COURT: The date they're terminating.
THE WITNESS: If they had 15 years or more of service under this plan which is, I would say, I don't want to call it

unusual, but in the minority of plans that would actually allow this person to be called a terminated, vested employee, entitled to terminated vest benefit, this plan which is generous would allow this person when they reach 55, because they have 15 years of service, to get that subsidized benefit.

THE COURT: At the age of 49?

THE WITNESS: No. They have to it till 55. They cannot get it at 49, but they would be entitled to that better benefit at 55.

THE COURT: Oh, I see. So they hold an entitlement, if you will, to some portion of a better benefit, but they can't collect until 55?

THE WITNESS: Right. The portion is based on what is accrued at the time they leave.

THE COURT: So the early retirement benefit of age 50, plus 15 years of service, how do you distinguish that from what we have just discussed?

THE WITNESS: Okay. Well, I think we are talking about the enhancement now?

THE COURT: I am talking about the prior plan, was an employee participant eligible under the prior plan? I want to nail that first before we get to the enhancement.

THE WITNESS: When the person leaves, regardless of their age, if they have 15 years of service, once they become age 55, they could start a pension, and that pension would have

been 60 percent of the accrued normal retirement annuity.

THE COURT: And that embeds, no matter how old they are, if they have 15 years of service, they have an embedded early retirement piece?

THE WITNESS: That this way the plan works.

THE COURT: Does the age 50 have any relevance in the prior plan?

THE WITNESS: No.

THE COURT: That is just really something for the enhancement for the new plan?

THE WITNESS: That's right. It was decided to have that eligibility requirement that you had to be 50 and 15 on the conversion date. Then you were entitled to an enhancement regardless of when you retired.

THE COURT: I got it. Thanks.

BY MR. RACHAL:

Q. Based on talking first about the prior plan, based on your experience with plans with similar early retirement subsidies, does everyone who is eligible for that benefit take it?

A. I would say that let's start with the people who when they leave employment are eligible to retire directly from employment, that is, they're over age 55.

I would say that most people at those ages are retiring and they would tend to take whatever the retirement benefit is under the plan whether it is subsidized or not. I

think they would be encouraged to retire with plans which have very rich early retirement subsidies.

For example, in this plan they reduce the benefit 60 percent. There are plans at 55 that don't do this, but there are some plans that actually do, but they might provide a very small reduction, much less than the 40 percent, maybe 20 percent, something like that, the better the early retirement provisions are, the more likely it is someone will retire early under those provisions.

Then when people retire early, they pretty well invariably take the benefit starting then. The question is if somebody leaves before 55, let's say that is as in this plan, the date you can first get your pension, so somebody leaves at age 40, I think 40, it is more likely than not under the provisions of the Foot Locker prior plan that that person would not take their benefit when they reach age 55.

Most people when they leave at age 40 are not really retiring. They're looking for another job, and hopefully for them when they get the other job, they'll reach age 55 and could they take the benefit?

Q. Yes, but they're presumably making income and most of them will, in my experience, will defer the commencement of the benefit until they actually retire, 62, 65, it depends when they're actually retiring because there is still a fairly significant reduction. Why take 40 percent reduction in the

pension when you can get the full pension at age 65 or get 80 percent of it at whatever that is at the earlier age.

Q. Under Foot Locker's prior plan, at least the Woolworth plan, what happened to this early retirement subsidy for those who wanted to continue working past age 55?

A. Talking about the prior plan?

Q. Yes.

A. Well, if they continued to work, they couldn't start their pension. They would have to leave before they could get the pension. As they're continuing to work, the value of the subsidy gradually declines and reaches zero once they reach age 65 because then you get full normal retirement benefit. There is no subsidy remaining.

THE COURT: So the value of the early retirement subsidy vests, if you will, or attaches at 15 years of service, correct?

THE WITNESS: I would say that's correct.

THE COURT: And it decreases annually in value following that period until the age of 55, at which point it is effectively zero. Is that right?

THE WITNESS: 65. In other words, once someone hits 55, if they start the benefits at 55, they're entitled to that subsidized benefit, then the full subsidy applies.

If they put off retiring or if they have left the company but put off electing to have the benefit start, then

every year from 55 until 65, the value of that subsidy decreases.

THE COURT: I see. So the decrease in value is a decrease which occurs annually commencing at 55 when they are entitled to take it to get payments for it until they're 65?

THE WITNESS: Yes. At age 65 they're just getting a normal retirement benefit.

THE COURT: I understand. Thank you.

BY MR. RACHAL:

Q. So does a participant's decision not to leave work or continue working, are they termed vested? They decide to wait on taking the benefit until they retire from their other job, age 62, 65, does that impact the expected cost of the early retirement subsidy to the plan?

A. Yes.

Q. DX-407, is that part of what is illustrated there, the difference in the break-off between the 10,000 to 13,000 and 17,000?

A. The difference between the 10,000 and 13,000 is because I don't know what Mercer would have assumed. Some somebody at age 40 when they assume they're going to start, and 15 years of service, say, do they assume those people would take their benefit at 55, which is the most heavily subsidized age, or they assume they're going to take it at age 65 or something in-between?

That is why there is this range. It wasn't clear from their evaluation report. At least it wasn't clear to me how they would handle that.

Q. All of those assumptions of the probabilities of whether someone would take the early retirement subsidy that would maximize the value of the subsidies would impact expected costs to the plan, correct?

A. Yes, and the 17,000 number anticipates -- but it is both the person has left, all right, put that in, and that they would take the benefit, this person who is age 39 would take the annuity, you know, at age 55 which I think is a very conservative assumption.

Q. Since this is dealing with someone who is post-conversion, they also would have to forego the right to a lump sum and elect annuity to give the right to early retirement subsidy?

A. That's right.

Q. What was the early retirement subsidy that was protected in the plan conversion?

A. Okay. The frozen accrued benefit which was expressed as an age 65 benefit, if somebody ultimately retires early, counting the years of service to get up to the 15, even after the conversion, so if they have 15 years of service by the time they leave, and they commence their benefit, elect to commence their benefit at age 55, then they would be entitled to that subsidy at age 55 through the frozen protected benefit.

So all the features that are associated with that frozen benefit in the prior plan would be attached to it, to the frozen benefit in the amended plan.
Q. Was any more value added to the early retirement subsidy after the conversion?
A. No. I think it just retained the value it had.
Q. Is it correct that to receive the subsidy, it had elected an annuity form of benefit, not a lump sum?
A. That is true.
Q. Post-conversion, what was the election rate for annuities versus lump sums?
A. Well, excluding those who cashed out automatically because their benefits were small and just looking at those who actually made elections one way or or another, my recollection is that the election rate for lump sums was 93 or 4 percent and that the remainder, 5 or 6 percent were annuities.
Q. What would someone like Mr. Osberg have to do if he were to receive the early retirement subsidy?
A. He would have had to wait until age 55 to receive it.
Q. Do you recall how many years --
A. And elected an annuity.
Q. -- do you recall how many years he would have had to defer benefit to receive the early retirement subsidy?
A. I think it was between 6 and 7 years.
Q. Did you calculate the value to Mr. Osberg if he had --

withdrawn. I know it is in the record.

Is it correct Mr. Osberg elected a lump sum form of benefit?

A. Yes.

Q. Did you calculate the value to Mr. Osberg if he would have waited 7 years instead of taking a lump sum form elected annuity with the -- what the value of that subsidy would have been to Mr. Osberg?

A. I calculated what I believe the benefit was under the frozen benefit as you have been describing reduced for early retirement, 60 percent. He had more than 15 years of service.

I also compared that to the benefits that are payable under the 1996 plans as I understand them that would have been payable at age 55.

Q. What was the difference between the subsidized and unsubsidized dates of 55 for Mr. Osberg you calculated?

A. I think it was $7.00 a month.

Q. Why was the early retirement subsidy worth so little to Mr. Osberg?

A. It was worth so little because there is, again as I understand it from what I've seen and looking at his calculations that were made on his actual, actually the date he elected the lump sum and some other calculations for others in the plan, or at least one other I was able to find, that the way in which the '96 plan apparently is being interpreted and

administered or at least was at a point in time was that you take the lump sum that he would have been entitled to, and in his case it is the lump sum based on his first protected benefit because he was still in wear-away, you take his frozen protected benefit and find the lump sum value of it at age 55, which is the date we are making the calculation, and then you convert that to an annuity using a subsidized interest rate, subsidized at the time because the plan provided for an annuity conversion that could never be less favorable to the employee than using a 6 percent interest rate.

Even though rates had dropped lower, lower than 6, the plan says when you convert lump sum amounts to annuities, you don't use a rate below 6 percent.

Q. Why was that valuable to use a greater of 6 percent or the actual 417 (e) rate to convert a lump sum to annuity?

A. Just the opposite of lump sum. You know, if interest rates go down -- go up, or higher, the lump sum is lower. Just the opposite when you convert to an annuity. If I convert a given dollar amount to an annuity, the higher the interest rate, the higher the resulting annuity. That makes sense when you think about it.

If you're in a high interest rate environment, you approach an insurance company, for example, you're going to be able to get a higher annuity. Why? Because the insurance company will be able to vest the money at a higher rate.

The same thing applies here, if I convert it at 6 percent rather than 5.48, which is the 417 (e) rate -- that was actually lower than that I am sorry. Let me correct that.

The 5.48 was the rate in effect in 2002 when he actually took a lump sum. By 2009, the actual rate came down to, it was about 4.4 percent, 4.4, something like that, around 4.4 percent, so the differential between 4.4 percent and 6 percent was very significant.

So that boosted up the annuity attributable to the frozen protected benefit under the '96 plan as I understand how it is being administered.

Q. That's, what you just described here, that is pursuant to the plan and that is different than the other type of whipsaw Mr. Deutsch was talking about earlier related to lump sums?

A. I believe that is true. When you say pursuant to the plan, Mr. Deutsch said while the plan calls for it, it is the way apparently it is being administered or at least was, you know, in some, you know, examples including Mr. Osberg's example, you know, in his calculation in 2002, also found one, I think it was one other, where it is hard to tell because when you are looking at actual calculation, unless that amount turned out to be higher than the subs subsidized -- in his case it is still $7.00 lower, not quite there, so you might have noticed it.

Q. Let me try it this way. What causes the benefit to be larger in the lump sum whipsaw, and call this plan annuity

whipsaw?

A. Well, following 417 (e) rates causes both lump sum whipsaw to be higher and in this case the annuity becomes higher than it otherwise would have been as well.

THE COURT: What do you mean by the word whipsaw? How do you define that?

THE WITNESS: Okay. Before Congress in 2006 passed a law that basically said when you pay somebody a lump sum from a cash balance plan, putting aside any minimum benefits, just from the cash balance account, that paying them a lump sum equal to the cash balance account is appropriate and totally fulfills the obligation of the plan.

Prior to that there was a methodology that the IRS had been applying, and they came out actually after this, shortly after this plan was converted in early 1996 when the revenue ruling that indicated, and had some details on whether you have to do survey data, what we call a whipsaw or round-trip calculation, where you take the person's cash balance account, you project it with interest to age 65, so based on the number of years and the interest rate, in this case 6 percent, easy, just a flat rate, you convert that to an annuity at age 65 based on the plan's conversion factors to convert, you know, accounts to annuities, and then you calculate the present value of that annuity, that cash balance annuity back to the original date when you start to make the projection, the date you're

paying out the lump sum, you can get an amount that is higher than the account balance.

If someone has a $20,000 account balance and if interest rates, 417 (e) rates are, say, 4.5 percent, when I project at my 6 percent interest credit, convert to an annuity and discount back at only 4.4 percent, what is going to happen is you're going to get an amount that is higher than the original account balance. That is called a whipsaw effect.

This plan, this plan incorporated that whipsaw calculation procedure, so there is an effect that has nothing to do with the frozen accrued benefit. It all has to do with the cash balance account. There is an effect in the plan that when interest rates fall below 6 percent, or as Mr. Deutsch said, it might not happen until you get to 5 and a half percent, where you would end up under the plan's terms with a lump sum that is higher than the individual's account balance.

(Continued on next page)

THE WITNESS: (Continuing) Now, in 2006, Congress decided that that really wasn't necessary or appropriate and --

MR. GOTTESDIENER: I am going to just object for the record, your Honor. I don't want to interrupt. But we object.

THE COURT: All right. Motion to strike denied.

THE WITNESS: They affirmed -- in my view and some other views, they changed the law to make it clear that for a plan like Foot Locker that credit 6 percent interest, and this followed IRS regulations, followed that up that you would not have to provide a lump sum with respect to the cash balance account that is any more than the account. In other words, you pay somebody their account. That's it.

Prior to that, Foot Locker and some other plans out there, there was litigation, a significant amount of litigation on this where the courts basically affirmed the IRS position that one has to go through and do this calculation, this type of calculation.

THE COURT: All right. Thank you.

Is now a good time to take our midmorning break.

MR. RACHAL: It is, your Honor.

THE COURT: Let's go ahead and do that.

Thank you.

(Recess)

THE COURT: You may proceed, Mr. Rachal.

MR. RACHAL: Thank you, your Honor.

BY MR. RACHAL:

Q. Mr. Sher, the whipsaw that you had just described, does that apply to all cash balance plans during the applicable period?

A. Well, I think there was some question as to whether it applied, but the courts took the position that it applies based largely on an IRS revenue ruling. But for a plan like Foot Locker where the interest credit is a fixed 6 percent, I think the argument is pretty strong that it ought to have applied.

Q. Was there another feature in the plan, at least that you saw in operation, that provided a benefit different or above this whipsaw feature under the law?

A. Well, I mentioned before that once you get the projected account with interest to age 65, the next step is you would convert that to an annuity based on the annuity conversion factors in the plan.

In most plans that I am familiar with, the annuity conversion factor is based on the 417(e) rates, rather than in Foot Locker's case it is the greater of the 417(e) rate or 6 percent. In other words, there is a minimum interest rate for converting that projected account to an annuity in this whipsaw calculation that serves to, when interest rates fall below 6 percent, serves to increase the resulting annuity from what would otherwise be the case.

So what that does is it -- the higher annuity when you

take the present value, of course, it's going to come up with a higher lump sum, whipsaw lump sum than would have resulted had you just converted it using the 417(e) rate, without the 6 percent minimum.

Q. When you reviewed Mr. Osberg's calculations of his benefit did you see that plan feature applied to his calculations, or did you conclude that it applied to his calculations?

A. The calculation of his annuity benefit that was on his election form, that was an annuity benefit shown that he could have elected a joint and survivor annuity for his spouse, so, yes, the calculation is consistent with using the 6 percent interest rate rather than the 417(e) rate to convert a lump sum to an annuity.

Q. In light of that, do you still conclude that your early analysis in your report that the early retirement subsidy was worth only about $7 a month to Mr. Osberg had he deferred commencement of his benefit until age 55 and elected an annuity, does that still hold true?

A. Yes. Because I don't see any reason why that calculation would be any different. Unless there was a change in the plan or in the administration of the plan in the interim, I think that's the kind of calculation that would have been made.

Q. There's been a suggestion that offering people the option to take lump sums saved the plan money over paying annuities beginning at age 55 with an early retirement subsidy, is that

correct?
A. It certainly was not correct in my view in the early years, and for that matter when interest rates fell there was even more of a differential between the 417(e) rate and the 9 percent rate, which would generate losses to the plan.
MR. RACHAL: Jon, pull back up DX 405.
Q. I'm moving now to point 2, which is whether the use of a 9 percent interest rate to set the initial account balance was actuarially reasonable.
First I am going to ask Mr. Sher some questions relating to the background of the plan first.
Is it correct that you have advised companies on redesigning their retirement programs?
A. Yes.
Q. Have you advised companies on program redesign when they were facing financial difficulties?
A. Yes, I have.
Q. Did you review Foot Locker's objectives in putting in place the new retirement program that became effective in 1996?
A. Yes.
Q. What was your understanding of the business background in 1995 that was leading to the program redesign?
MR. GOTTESDIENER: Objection, your Honor.
THE COURT: I will allow it, consistent with my earlier rulings. You may answer.

A. My understanding was that the company was experiencing financial difficulties, was factor number one. Factor number two was they were restructuring, in the process of restructuring from a general to specialty type retailer, Woolworth's to Foot Locker.

Then they were in an environment where when they were looking at what competitors did. They saw, that is, all of us who were in the industry saw at the time that there was a move away from traditional defined benefit plans to account balance plans, whether they be defined contribution plans or the cash balance plan, which is a defined benefit version of an account balance plan.

Q. What were the stated objectives to the redesign of the retirement program for Foot Locker?

A. Well, one that seemed to be first on the list all the time was cost reduction. They were definitely looking to reduce cost of the program.

The second one was they were looking to modernize the plan, which as I understood it encompassed introducing more portability and flexibility in the kind of benefit distributions. I read that to mean lump sum distribution.

The third one was shared responsibility, which means -- which can mean shifting some costs to employees, but it also means I think in most cases providing incentive for employees to save through a matching scheme, which is what the

401(k) plan did. So it was providing a tax deferred vehicle, 401(k), and also providing matching contributions to encourage employees to contribute more.
Q. Do large employers rely on actuarial consultants in converting pension plans to a new design?
A. I think they do in most situations.
Q. Why is that?
A. Except for some very large companies in some isolated situations, usually they don't have actuarial expertise in house, so their inclination is to hire a consulting actuary or a consulting actuarial firm to help them through the process.
Q. Is it correct that large employees almost invariably have substantial financial expertise in house?
A. Yes, they do.
Q. Why does that financial expertise not substitute for actuarial expertise on plan design?
A. The financial executives that I have come in contact with over the years, while they are for the most part very smart, know what they are doing in terms of the bigger company issues, when it comes to pensions, defined benefit plans and all the technical and regulatory aspects of them and actuarial aspects of them, they need the help of an actuary to help them understand all of that.
Q. Do clients typically set the goals of the new plan design?
A. I would say that, yes, that ultimately it's the client who

has an issue or problems, things that they don't like, things they are trying to accomplish that aren't being accomplished currently.

I think what the actuary can do in that situation is to help them shape those goals and make sure that the goals are not conflicting. Often you hear things, we want to improve the benefits, but we don't want to spend any more money.

So we come in and we go, well, wait a minute. Something has to give here.

So the actuary can help sort of referee, if you will, conflicting objectives that often different people within the organization have to try to make sure that the goals are at least potentially achievable.

Q. Subject to setting these goals, do the clients typically defer to the actuarial consultants?

MR. GOTTESDIENER: Objection.

MR. RACHAL: I'm sorry.

MR. GOTTESDIENER: I thought you were finished with the question.

MR. RACHAL: Do you want me to do the whole question?

THE COURT: It's always better to get the whole question out.

MR. RACHAL: OK. Good. Thank you, your Honor.

Q. Subject to setting these goals, do clients typically defer to actuarial consultants on plan design features implementing

those goals?

MR. GOTTESDIENER: Objection.

THE COURT: Overruled. I will allow it.

Ultimately this question is determined by the fact witnesses in this case. He can only say what really happened here based upon the record that he's seen, and ultimately that's what is most relevant. But you can just set the background for wherever you are going next.

MR. RACHAL: Thank you, your Honor.

BY MR. RACHAL:

Q. Go ahead.

A. Based on my experience I think I have seen it all over the lot to put it that way. I've seen situations where the company says, or the individuals involved say, OK, I want you to come up with a recommendation for this plan. What is your best recommendation, and that's what we want to see. Tell us what it's going to cost. Tell us how it's going to affect people.

The other side of that, the other extreme is, I want to see everything that everyone out there is doing, I want to see variations on everything that they are doing. And then we will decide, and costs and benefit illustrations and all that, and we will decide what to do, give us the information, and then we will decide what to do. And then there's everything in between.

Q. Did you review Mercer internal documents relating to the

Foot Locker cash balance conversion?
A. Yes, I did.
Q. Did you review Mercer's documents that were sent to Foot Locker relating to this plan conversion?
A. Yes, I did.
Q. Based on your experience, do these documents show the typical level of deference to actuaries by clients regarding this cash balance conversion?
MR. GOTTESDIENER: Objection.
THE COURT: Can you restate that question, please.
BY MR. RACHAL:
Q. Based on your review of these documents, what type of deference, if any, did you see between the actuary Mercer and Foot Locker?
MR. GOTTESDIENER: Objection.
THE COURT: Sustained.
I mean, it's not relevant to me what he saw as a level of deference. If you want to ask him about the particular work that Mercer did, you can do that, but I don't want to have him discussing levels of deference.
MR. RACHAL: Sure.
BY MR. RACHAL:
Q. Plan design features like the interest crediting rate and the pay crediting rate for the cash balance plan that was discussed between Mercer and Foot Locker and ultimately adopted

by Foot Locker, what did you see based on your review of the documents?

MR. GOTTESDIENER: Objection.

THE COURT: I'm just reading the question.

Can you restate the question. I mean, I guess the concern I have is are you still asking about deference, because as phrased currently the question is extraordinarily broad, which is what did you see based on your review of the documents. So that's just too broad. It could be that I saw --

MR. RACHAL: I understand.

I will try to narrow it.

THE COURT: All right.

BY MR. RACHAL:

Q. Regarding the pay and interest crediting rates for the Foot Locker cash balance plan, what did Mercer offer or suggest to Foot Locker?

A. Let's start with the pay credits.

What I saw was really a variety of possible pay credit schemes. Some of them were age based, some of them were service based, some of them had what we call, were integrated with Social Security where there is a lower percentage pay credit rate for compensation up to a given level and then a higher percentage above that level.

Within at least some of those categories I saw

variations on how many different tiers there were in the formula, anywhere from I think three to at least eight.

So I did see, I would say, a pretty good variety of pay credit rates that were, at least at some point in time were looked at. I don't know how many of them were seriously considered, but at least there were a bunch that were presented.

Q. What about on the interest crediting rates?

A. On the interest crediting rate, from the earlier documents they were talking about, it seemed to be suggesting a fixed 5 percent rate. Later on, as they got towards the final, what turned out to be the actual service-based, eight-tier scale, the interest rate was changed to 6 percent.

Q. What did you see regarding the 9 percent interest rate that was used to set the initial account balance between Mercer and Foot Locker?

A. I just saw 9 percent. I don't know -- I didn't see any other proposal or I don't even think I saw a discussion, at least in the record, of using an alternative rate.

Q. Did Mercer articulate why it thought that 9 percent rate was a rate to use to set the initial account balance?

MR. GOTTESDIENER: Objection.

THE COURT: Yes. What I don't want to do, I think it's really not useful for us to spend our time having him talk about what Mercer did or did not articulate.

He can talk about what the 9 percent means, whether or not the 9 percent was reasonable or whatever he wants to say about the 9 percent. But the did Mercer articulate why, I am not going to rely upon this witness for that factual testimony. That's got to come from a document or something else in the record.

MR. RACHAL: Sure.

THE COURT: You have him talk about the 9 percent to your heart's content, but not in terms of using him as the vehicle to get it into the record and the rationale for it, except in terms of industry rationale for using certain interest rates, etc., etc., and whether what he saw here was consistent with that, things of that nature.

MR. RACHAL: Thank you, your Honor. I will move on.

THE COURT: All right.

MR. RACHAL: Jon, pull up DX 409.

BY MR. RACHAL:

Q. For the prior, preconversion plan what was the benefit it offered?

A. Well, as we were discussing I think before, they changed the nature of the plan. That was a career, what we call a career pay plan.

Do you want -- do you want me to talk about the optional forms that were available, payment forms?

Q. Under the prior plan, other than for cash-outs, which I

think were $3500 or under, could you get a lump sum under the prior plan?
A. No.
Q. Could you commence an annuity before age 55 under the prior plan?
A. No.
Q. Was there any distribution flexibility offered by the prior plan?
A. Well, there was some, but limited. I mean, you could start your benefit as early as 55 in the form of an annuity. There were various annuity forms that one could elect, a straight life annuity, a joint survivor annuity, for example.
But otherwise that was pretty much it.
THE COURT: Let's assume for the moment that I am an employer and I have in place the Woolworth retirement plan as of 12/1/95. So we are at the beginning of December '95.
Could I just amend that plan to include a lump sum option without converting to a cash balance plan?
THE WITNESS: Yes, you could. You might not want to, but you could.
THE COURT: Are there any particular reasons why you say I might not want to?
THE WITNESS: The reason that many companies in that situation have not provided a lump sum is that the lump sum will fluctuate every year. As the interest rates change, the

lump sum is going to go up and down, up and down.

That is considered to be a difficult provision if you are going to provide a lump sum. The idea behind cash balance is you're creating this account that acts more like a short-term investment, where you've got principal and interest guaranteed, and it's always going to go up nicely. It's never going to be subject to the ups and downs of the market.

That's the idea if you are going to provide a lump sum. Cash balance design avoids that kind of fluctuation, which creates problems for everyone, financial problems for both the company and the individuals.

THE COURT: All right. Let me just ask whether you are aware of companies which have career average plans, defined benefit career average plans similar generally speaking to that which Woolworth had prior to amendment which included a lump sum option?

THE WITNESS: I'm pretty confident there are some out there. I can't recall one off the top of my head, but I would be surprised if there weren't some. About 25 percent, at least that's the last time I looked at these numbers, about 25 percent of traditional type defined benefit plans, in other words, not cash balance type plans, do provide a lump sum option. The other 75 don't. So there are probably some career average out there. I just can't think of one off the top of my head.

THE COURT: All right. Let me ask, then, a different question: As I understand it, there is an ERISA rule which provides for an immediate lump sum payment to those individuals who don't have -- maybe it's an IRS rule -- a specified level of earnings, and that in the '96 time frame that level was $3500. So if you terminated as $3500 or less you automatically got a lump sum, is that right?

THE WITNESS: OK.

There is a provision in the law --

THE COURT: Is that right?

THE WITNESS: -- that lets you. It is a voluntary provision. You don't have to have that provision.

THE COURT: Yes. Is it an IRS or an ERISA regulation?

THE WITNESS: It is an ERISA rule. The IRS carries it out. It's in the law.

THE COURT: Is it something which you have to include in your plan, or can you elect year to year to do that?

THE WITNESS: You do not have to have it in your plan. Once it's in your plan, I think there is a way you can get out of it, but in general, you do not have to have that provision in your plan.

THE COURT: Woolworth had that provision in their plan. Am I correct?

THE WITNESS: Yes. Woolworth, like most companies I would say, most plans do provide for that. But the amounts are

small. It's, let's pay the person out rather than holding it.

THE COURT: It lends itself to easier administration?

THE WITNESS: Yes.

THE COURT: It don't ends up just accruing very tiny participants, is that right?

THE WITNESS: That's right, and participants who are likely to sort of forget they even had it, and you try to contact them for these small annuities and you are paying PBGC premiums to the government as well.

THE COURT: Let me ask.

At Woolworth I have heard different things in terms of the prevalency of this $3500 lump sum payout. What is the denominator, if you will, of all individuals eligible for some form of retirement payment. And then of that, and you can pick a year or a range of years if it is easier for you to do it that way, and of that overall denominator which includes these $3500 or less folks, what percentage are the $3500 folks?

For instance, if we've got 16,000 participants, are 10,000 of them $3500 folks? That's what I am looking for.

THE WITNESS: I don't think the number is that high, but it's several thousand.

THE COURT: So is 16,000 approximately the right denominator?

THE WITNESS: Yes.

THE COURT: And several thousand of those participants

would be $3500 participants?

THE WITNESS: Either they were already because they terminated, or when they terminated they might very well. Although a lot of them, if they terminate, you know, later on, they are going to build up enough benefit where you wouldn't expect it.

THE COURT: So would it be between 10 and 20 percent approximately? Is that a rough?

THE WITNESS: I really don't recall. I remember it was a pretty large number when we were looking at some of the years like 1996, '97 and '98. Whether it was 20 or 30 percent, I real -- it was a pretty good number.

THE COURT: So for those folks, they had a portable lump sum option out of the box, right?

THE WITNESS: Well, it wasn't an option. It was a mandatory cashout. They were just paid.

THE COURT: Right. They could not stay in for an annuity.

THE WITNESS: That's right.

THE COURT: Got it.

You may proceed, Mr. Rachal.

MR. RACHAL: Thank you, your Honor.

I think the number is in the record. I think Mr. Deutsch's report.

Do you all recall where?

MR. GOTTESDIENER: In the rebuttal.

MR. RACHAL: In the rebuttal report it does have the percentage of cashout.

THE COURT: I will take it because you are referencing it as a number you don't disagree with.

MR. GOTTESDIENER: I don't think so.

MR. RACHAL: I don't recall us having an issue with it. You can talk. He said 40 to 60 percent.

THE COURT: I will take a look at it.

MR. RACHAL: I don't know about that number.

THE COURT: That's fine.

MR. RACHAL: I know it is in the report. I know we looked at it and didn't have an issue with it.

THE COURT: Can you find that number for me, Mr. Huang, in the report. Find me the paragraph, since you are the go-to guy for all paragraphs. You can ask your neighbor if you want.

You may proceed, Mr. Rachal.

BY MR. RACHAL:

Q. Going back to the prior point, I just had a couple of follow-up questions or closing out questions.

What happened if the participant was in poor health under the prior plan and terminated employment?

A. Well, if they were single, I think they would get, you know, before retirement, I don't think anything, they would get

nothing.
Q. They would lose their benefit?
A. If they were married, there would be some type of a joint and survivor partial type benefit payable to the spouse.
Q. Could a participant in poor health take advantage of her knowledge of that poor health to cash out the annuity as a lump sum under the prior plan?
A. No.
Q. Could they in the converted plan elect a lump sum if they were in poor health.
A. As long as they were in poor health and they terminated employment, yes.
Q. For employees, what was the main benefit offered by the postconversion cash balance plan?
A. I would say the main benefit was the ability to get a lump sum cashout.
Q. Was that lump sum what they call portable?
A. Yes. Portable in the sense that they could take the benefit with them when they left.
Q. How soon did they have to elect the lump sum? When did they have a window to elect the lump sum under the converted plan?
A. They had a six-month period to elect either an annuity or a lump sum.
Q. After they --

A. Right now if they were already over age 55 they could elect it at any time. Otherwise, if they passed the six-month period, they would have to wait until age 55.
Q. Was it common to provide a window for electing distributions?
A. I would say that there is a variety of situations generally, in a cash balance plan in particular. I would say that in some plans it was totally unrestricted. They could come in at any time they wanted and make an election. In other plans, they might have to wait until age, something like age 55.
In other plans, you either -- if you wanted a lump sum you had to elect it right away or you couldn't get it later on. It is just a onetime, you know, six months, something like that, all types of varieties, to unrestricted, to restricted, in various ways.
Q. What are the options -- now we are talking about under the converted plan -- does a participant have if she decides not to take a lump sum distribution at termination?
A. If they decide not to take the lump sum within the six months and the person is under age 55 they would have to wait until 55, in which case the account stays in the plan, and continues to get credited with 6 percent interest until once they become 55 or after they either elect to take, you know, take a lump sum or take an annuity.

Q. During that six-month window could they also elect an annuity form of benefit?
A. Yes.
Q. When the plan was converted to a cash balance plan, did Foot Locker have to offer lump sums to the prior accrued benefit?
A. No, they didn't have to.
Q. Did creating a portable lump sum for the prior accrued benefit provide financial advantages to participants?
MR. GOTTESDIENER: Objection.
THE COURT: I will allow him to answer that in terms of the theory of it. Before we get there, let me interrupt and just ask you whether or not cash balance plans typically in your experience are accompanied by a lump sum option?
THE WITNESS: I would say -- I don't want to say invariably, but close to invariably, there are some that, there are certainly some that restrict the lump sum in the ways we just talked about, in terms of timing, and there are some others that restrict lump sums in terms of the portion of the benefit that can be taken in a lump sum, or the dollar amount, you can't get a lump sum up to $20,000 say, something like that. But the majority of them, the vast majority allow a full lump sum.
THE COURT: Let's go to the next question, which is Mr. Rachal's question, which is, in your experience and based

upon your knowledge of the theory of cash balance plans, the theory behind them, what advantages are they intended to provide financially for participants, if any?

THE WITNESS: Well, I would say, and this goes really for lump sums, generally, an individual can take their lump sum, and they have tremendous flexibility in what they do with it.

They can use it to meet current financial, pressing financial needs, health problems. They can use it to cover pretty much anything. They can pay down credit card debt that's over 20 percent that they are paying out. They can use it to invest in a business, or they can invest the money.

Of course, that's really I think what most people do, is they roll over at least a portion of a lump sum, particularly when it is a good amount of money in there -- if it's small, they might not bother. But if they gathered up, you know, a pretty good sum of money, there's a tendency to roll over at least a portion of it to an IRA and then have it invested the way they and their financial advisers recommend.

THE COURT: Are you aware of tax consequences associated with the utilization of lump sum payments other than for retirement purposes when an individual is below a certain threshold age?

THE WITNESS: Well, the -- yes. When they are below 59 and a half, there is an excise tax that is payable in

addition to the regular income tax.

THE COURT: If I took my lump sum, I've got 20 grand I'm 40 years old and I just take it and pay off credit card --

THE WITNESS: You are going to pay a lot of taxes on it.

THE COURT: I am going to pay tax.

THE WITNESS: You are going to pay taxes at whatever your tax rate is.

THE COURT: So long as my tax rate is lower than the credit card interest rate.

THE WITNESS: It might still be worth it, right.

THE COURT: All right.

THE WITNESS: Eventually, when the money is pulled out, whether it's now or any time in the future, even if they invest the money, you know, they are paying, depends on how they invest it, they will be paying some income taxes, unless it's municipal bonds or something like that, but if it's in an IRA, then the tax is deferred, until they pull the money out. Then, of course, they are paying taxes on the whole thing.

THE COURT: I'll really referencing the other ways in which you thought that a participant who had pulled their money out could utilize that money. Whether or not it makes financial sense to that individual would depend largely upon his or her circumstances.

Am I correct?

THE WITNESS: Of course, yes.

THE COURT: And age is certainly one of those?

THE WITNESS: Yes.

THE COURT: Because otherwise there would be tax consequences that would have to be offset.

THE WITNESS: That's right.

THE COURT: All right. OK.

THE WITNESS: Also, the other advantage --

THE COURT: We'll wait.

THE WITNESS: OK.

THE COURT: Do you want to have him list any other advantages?

THE WITNESS: I don't know if I covered -- did I miss something you wanted me to cover?

THE COURT: He'll follow up if he needs to.

MR. RACHAL: I will follow up Mr. Sher.

BY MR. RACHAL:

Q. This may be what you were referring to. What was the impact, if any, on the portable lump sum for those who had health issues?

A. Well, I think I said, you know, for -- if they get the lump sum, first of all, which is a good thing, then they can utilize it to pay health expenses. And if they could get a lump sum, of course, if it is a health condition that's shortening their life expectancy, it could be particularly helpful and they

could then pass on money to their heirs.

THE COURT: I'm sorry. Now I do have to ask this question, which is are you aware of whether any participants in the Woolworth plan who took out their lump sums actually used it for payment of any health-care related expenses?

THE WITNESS: I do not know. As you said -- this is.

THE COURT: Theoretical.

THE WITNESS: It's theoretical.

THE COURT: Thank you.

BY MR. RACHAL:

Q. Talking about the protected lump sum benefit which is converted into an annuity, is it correct that even if someone had a serious health issue, knew they were going to die within the next year or two, that that annuity is not impacted by the person's particular circumstances? It's going to be the same as if somebody were healthy? Is that correct?

A. The amount of annuity, the dollar amount of the annuity, that's correct.

Q. That dollar amount of the annuity is going to be converted to a lump sum whether regardless of whether the person was going to live one year, five years, ten years?

A. Yes. There is a standard mortality table that's used. It does not take into account different health conditions.

Q. Was converting the prior annuity benefit to an opening balance a common approach for cash balance conversions during

the 1980s and 1990s?

A. I would say not only was it common it was a substantial majority of companies that I am aware of, based on surveys that I have done and also just based on my knowledge, you know, from being around the profession. It is 85 to 90 percent, something in the area.

Q. Why did the companies do that based on your experience?

A. I think they did it primarily because they really wanted to convert from one paradigm to the other in the most complete way that they could. That is, they wanted to provide an account balance and a lump sum under the new paradigm not only for the future credits, the pay credits and interest credits going forward, but also for the existing benefits from the prior plan.

They felt that employees would rather have that. You know, otherwise what happens is when you do the conversion, the tendency would be -- if you are only providing a cash balance on the future pay credits, then someone who just leaves shortly after the conversion would get a very small lump sum and most of it would be payable under the prior form, the annuity form.

Q. Is an opening balance approach different than an A plus B approach?

A. In my experience, they're much different. They are sort of the opposites, opposite side of the coin.

Q. So describe what is the A plus B benefit or A plus B

approach?

A. The A plus B approach, as I understand it, is the A benefit is usually the frozen accrued benefit under the prior plan. Most of the time it is a frozen benefit in terms of both service and compensation. It is just whatever it was at the time.

Usually it's payable in whatever forms the prior plan paid those benefits under, which could have had a lump sum, in which case it would be payable in the lump sum. But if it didn't, as in the Foot Locker case, in my experience most of the time an A plus B in its purest form would just stick with whatever the optional forms were under the prior plan and then starts fresh. There is no opening balance. There are pay credits and interest credits starting with a zero balance.

(Continued on next page)

Q. Using Mr. Osberg as an example, I think his frozen accrued benefit I think was around $6,000, $6100 at the time of conversion. On an A plus B plan, the A part would be that frozen annuity going forward, correct?
A. That's right, unless there was a decision to pay that as a lump sum as well.
Q. And the B part, what would the B part be?
A. It would be pay and interest credits beginning in 1996.
Q. Can an employer offer a lump sum for the A part of an A plus B benefit?
A. Yes, they can.
Q. Was that common?
A. In my experience, first of all, most of the plans I'm aware of did not do an A plus B in the first place.
Among those that did, most of the time, in my experience, if they did not have a lump sum before, they continued that and just started the cash balance. The only lump sum would be the pay interest credits going forward, the Part B.
Q. Why is it that they would offer a lump sum for the A part in an A plus B benefit? Would an employer not do that?
A. Because for the same reason a lot of these companies didn't want to have a lump sum in the past. The notion of embracing a lump sum on that frozen benefit was equally unappealing because of the great fluctuations in the lump sum values due to

changing 417 (e) rates.

Q. Did Mr. Deutsch's report provide an example, illustration of fluctuating value for this lump sum Part A benefit?

A. I believe it did. I think he referred to the variability of the value and he took a 30-year old and indicated that a half of a percent change in interest rate would change the value by I think he said about 20 percent.

So if interest rates went either up or down half a percent, the approximate effect on the present value of that age 65 annuity benefit, presently age 30, would go up and down, obviously, with interest rates, of course, by about 20 percent.

THE COURT: Can I ask a question. I am sorry, Mr. Rachal. I said this is the problem of having the last witness be somebody who is an expert.

Let's talk about the A plus B plan.

THE WITNESS: Okay.

THE COURT: Let's assume that what I want to do is implement an A plus B plan in a sounds like traditional way.

I am going to have my frozen accrued benefit, it will be frozen in time, and I am going to add separate from that interest and pay credits, and the employee, when he or she retires would the get A, the frozen accrued plus whatever the B is. Are you with me?

THE WITNESS: Yes.

THE COURT: On day one of that plan implementation,

switching now to thinking about the liabilities of the plan, my liabilities include zero, now nobody has worked a minute, the liabilities of the plan include a hundred percent of the frozen accrued benefits, correct?

THE WITNESS: That's right.

THE COURT: That means that my liability for the future will be that total accrued liability for the plan plus interest and pay credits as the employee goes along.

Is that right?

THE WITNESS: So far I think that is right on.

THE COURT: And that's different, isn't it, from the liabilities of the plan here which during the period of wear-away, for an employee in wear-away did not increase the liability of the plan. Is that right?

THE WITNESS: Through the normal cost being reduced, which reduction is for people in wear-away, there would be a period, we don't know how long the period is because it depends largely on how those interest rates fluctuate but, yes, there would likely be a period as the actuaries estimated where there would be, liabilities would basically remain stable.

THE COURT: So if I, in doing an A plus B, said to you I don't want to increase plan liabilities for at least substantially for several years, you might recommend I might not do A plus B?

THE WITNESS: No, I don't know that I'd say that. I'd

say, first of all, if you do A plus B, if we're talking about the A not providing lump sums --

THE COURT: No. I want to say A is going to provide lump sums frozen accrued benefit?

THE WITNESS: That is a different story. Now you would get --

THE COURT: Necessarily?

THE WITNESS: -- necessarily you're going to get some increase.

THE COURT: In plan liabilities?

THE WITNESS: In plan liabilities by doing that.

THE COURT: All right. You may continue.

BY MR. RACHAL:

Q. Just to wrap up my point.

Is the increase caused by the difference between the plan's expected earning rate, here it was 9 percent and whatever the 417 (e) rate was at the time of the merger?

A. The actuary would make a forecast, again assuming they make some assumption, it is eventually going to hit the books of the plan one way or another.

If they're paying out lump sums, whether they assume people take lump sums or not, once they pay them out, there is going to be an impact on costs because of the differential between the rate that is used to calculate the lump sums and the expected earnings rate.

Q. Going back to the example where a half percent change in 417 (e) rate caused a 20-something percent change in the protected lump sum, about 20 to 1 ratio, is that partially a function of A times B factor when you try to figure out the impact of the variability of interest rate changes affecting the protected lump sum?

A. Age --

MR. GOTTESDIENER: Objection.

THE COURT: Hold on. Let me read this question again.

(Pause)

THE COURT: Overruled. I will allow it. You may proceed.

A. Somebody age 30, as in Mr. Deutsch's example where he said there was a 20 percent for half of a percent effect, he was talking about an annuity, valuing an annuity beginning at age 65.

If someone were younger, the effect would be even greater. If someone was older -- say, age 65 -- the effect would be quite a bit less. It would vary. The time horizon, the further a person is away from when benefits are projected to begin, the longer the money is going to be in the plan; and, therefore, the differential of interest rates is going to make a bigger difference.

MR. GOTTESDIENER: I wanted to note for the record our only objection to the question was 20 to 1. We didn't have a

problem with the 20 percent. That is just for the record, your Honor. We weren't objecting to the question.

THE COURT: I have to say, since I didn't understand that as a nuance, I didn't understand the objection. So if you got what you think you needed, Mr. Rachal, then that is fine. If you want to re-ask the question, go ahead and re-ask the question. I didn't get the nuance.

BY MR. RACHAL:

Q. Is it the same answer except the ratio would actually be 40 to 1, not 20 to 1, half a percent to 20 percent?

A. You're saying for each one percent change in interest rate, it would be about 40 percent change in the value?

THE COURT: That's a little bit different.

BY MR. RACHAL:

Q. Let's take Mr. Deutsch's example, a half percent change in interest rate, and it had a 20 percent something change in the protected lump sum value, that is about a 40 to 1 ratio, correct?

A. 40 to 1 when you're talking about for each one percent change, you get about a 40 percent change.

Q. I had misstated the nature of the ratio.

MR. RACHAL: Would put up DX 410.

BY MR. RACHAL:

Q. I will talk to you about the impact of future interest rate changes upon the plaintiff participants. What were some of the

other benefits provided to participants by the post-conversion cash balance plan?

A. Okay. Well, let's start with the cash balance account provides a guaranteed, stable lump sum benefit that regardless of what happens to interest rates, the account is going to remain the same. It has got a fixed interest credit rate. The account is not going to go up and down with interest rates.

Normally when interest rates go up, you get, in effect, on an annuity, when you value an annuity benefit like lump sum value of the protected benefit, the interest rates go up, the value of the protected benefit would go down, which would, if somebody, for example, might have been in wear-away, that would take them, reduce the wear-away or take them out of wear-away just by virtue of a rise in interest rates.

You know, the individual, if all he had was the protected benefit, and he took a lump sum of that, let's say the prior plan had been frozen, all he did was take a lump sum, interest rates went up, you get whatever the lump sum value is, whereas the cash balance would provide a floor of protection against raising interest rates.

THE COURT: Do you have any recollection, as you sit here today, what your expectation was as to interest rate changes during the '96 time-frame in a sort of a few years from that horizon?

THE WITNESS: Well, I can tell you that I don't recall

whether I had a personal expectation. My theory has been it is hard to predict. I am no expert on predicting where interest rates are going.

My recollection is that economists were kind of mixed at the time, although there was one school of thought that I think I saw at a lot of companies was that rates would come down lower, lower than they had been in most of the last 15 years or so and that there was a concern, not necessarily a prediction, but a concern that inflation could rear its ugly head again.

Some of it is just, you know, people who lived through the 80's and experienced the hyper-inflation when I remember a lot of economists back then saying you'll never see several digit inflation again. There was still some residual feeling about that. At least that is what I remember reading at the time.

Actuaries tend to be less inclined to change their views of what is going to happen often than economists, in my experience.

Here you have rates coming down. Actuaries were still assuming for a long time investment return rates of 9 percent. It is only really in recent years that you finally see some of these return assumptions that actuaries are making come down from the 8 and a half, 9, 9 and a half rates, more like 7 percent even though inflation has been the way it is. If you

keep near, the inflation will come back, the Feds will drop controls and it will be off, not only inflation, but if the Fed drops their controls, it will happen when they fully lift them.

I would say the mindset was there was some concern the rates would come back up, so there was a tendency to discount to some extent real short-term rates. When they saw them coming down, I think there was a tendency in the survey we did revealed that, some tendency to not give that real recent experience a lot of credence.

THE COURT: What is the survey you're talking about?

THE WITNESS: The PWC survey.

THE COURT: The interest rates?

THE WITNESS: The opening balance interest rates, and we analyzed how the level of the rates and the marketplace was affecting the relationship between the 417 (e) rate and the opening balance rate. The rates were coming down, there was a tendency not to give that a full, you know, full effect.

THE COURT: Thank you. You may proceed.

BY MR. RACHAL:

Q. Let me focus on this part of the slide with the interest rates going down. It talks about the value of the 6 percent fixed interest credit rate increasing. I think we will talk about that in a little bit for in a few minutes.

In the Cigna plan, did it have a fixed interest rate or floating rate?

A. It had a combination of the two. It had a floating rate, and at the same time -- what I mean by that, the rate would vary each year depending upon the level of -- their plan was a little complex, as I recall. It was based on a particular government bond with add-on, I think an add-on adjustment, margin added onto it.

They also had a 4 and a half percent floor and I think it was a 9 percent ceiling, each year's rate.

Q. If interest rates in that situation fell from 6 percent to 4 and a half percent, the participants would give us money on the interest rate?

A. Yes. They wouldn't go below the 4 and a half. If the rates had been up around 6, and until it got down to 4 and a half on that index, they would get 4 and a half.

Q. And then the whipsaw features, I know we talked about two different features. One is the whipsaw applied to lump sum balances where you go up and back, the account balance.

That applied to the Cigna plan, too, correct? That is a rule of law?

MR. GOTTESDIENER: Objection.

THE COURT: Hold on. Why don't you rephrase it.

BY MR. RACHAL:

Q. Is there a difference on the whipsaw feature between the Foot Locker plan and the Cigna plan?

A. I am trying to recall. I don't really recall how whipsaw

was handled in that plan. It has just been a while since I looked at it.

What complicates that is the fact that that plan had a variable rate, and when you project -- what do you project forward to make, determine the longer time benefit in a whipsaw calculation. Whether that plan even had a whipsaw provision, and some plans resisted putting in whipsaw provisions in until the guidance, they felt guidance was clearly requiring them to.

Others like Foot Locker put it in the plan. I don't recall what Cigna did in that regard.

MR. RACHAL: Would you pull up DX-12, at Page 19, Mr. Sher's opening report that shows the table.

BY MR. RACHAL:

Q. First, does this table assume the same starting point for the account balance?

A. Yes. I don't recall the age of this, but whenever it was, it would be their balance at the beginning of '96. There was a hypothetical example of an opening balance both at the -- I believe at the 9, the actual 9 percent rate.

THE COURT: What is the corresponding PX if, we have it, to DX-12?

MR. HUANG: I don't believe there is one for this.

THE COURT: No, I don't think so.

MR. RACHAL: It is Mr. Sher's report.

THE COURT: Mr. Sher's report itself?

MR. RACHAL: Yes. It is DX-12.

MR. HUANG: PX-90.

THE COURT: Thank you.

MR. GOTTESDIENER: Could I just ask for clarity for the record, this is discussing not the Foot Locker plan? This is discussing a not the Cigna plan? This is just a hypothetical cash balance plan?

THE COURT: Is that right?

BY MR. RACHAL:

Q. Mr. Sher?

A. I think the 6 percent interest column is intended to indicate what an individual who has an initial balance of 13,959, I am sure I went through a calculation, I would have come up with some-odd number like that unless there was some calculation that developed it.

I think that was intended to be a Foot Locker, at 6 percent interest per year, that that balance would grow high in the Foot Locker plan.

THE COURT: I see DX-12 is actually your report.

MR. RACHAL: Yes.

THE COURT: DX-12 is not the document. That document is just an excerpt on the page of the report?

MR. RACHAL: Yes. This is from Mr. Sher's report.

THE COURT: Got it.

THE WITNESS: It begins on Page 18 and continues onto

19.

THE COURT: All right. Fine.

THE WITNESS: This is a person who is 45 years' old, with 15 years of service, who had a $10,000.00 frozen accrued benefit at age 65.

(Off-the-record discussion)

BY MR. RACHAL:

Q. So the right column, one year Treasury rates, that is not the Foot Locker plan, correct?

A. No.

Q. Why did you select one year Treasury rates as a comparison?

A. What I was saying is if the person took a lump sum right after the plan was converted, January 2nd, 1996, they took their opening account and they invested it in the market, in the outside market, what would they be able to invest in that would give them the same level, the same type of protections that the account balance had in the -- if it is stayed inside of the Foot Locker plan; in other words, an investment where there was a guarantee of principal no matter what happened to interest rates or the marketplace and where the interest was guaranteed as well.

So a comparable outside investment where they can get that type of guarantee, basically little or no risk, what kind of investments are in the marketplace? One year Treasury rates. There was no fluctuation of value. It is a guarantee

of principal and interest. That represents a market rate of return that can be achieved with the same level of risk.
Q. Are the post-conversion, are the one year treasury rates actual rates?
A. These are rates that I believe it is in the report, I believe that each year what I assumed was that towards the end, like in December, there be an investment at that point in whatever the one year treasury rates were at that point in time, and that would be held, the investment would be held for a year and then rolled into a new one year treasury rate because it would mature at whatever the rate is at the beginning of the next year, I just took it through until the end.
Q. Did you use the actual one year treasury rates in effect from 1996 to 2011?
A. Yes.
Q. What did you you get for 2016?
A. After 2011, I assumed the rates remained at the same level they were at for 2011.
Q. Does this table illustrate the type of benefits a participant received or would receive if rates fell post-conversion?
A. So if rates fell post-conversion, which they did, the plan 6 percent is what they would receive in their cash balance account. Again this is just looking at an opening balance.

There are no pay credits, just focusing on the opening balance. It would grow to, in 2016, 20 years later, at 6 percent interest, to 44,768. On the other hand, if they turned and took the money and invested it in one year treasury rates, rolled it over each year, they would end up with 23,000.

THE COURT: What if we took the starting amount is the $10,000.00, is that what you started with?

THE WITNESS: No. It was the 13. The 10,000, your Honor, was the accrued benefit age 65 that was converted to an open balance. The opening balance for this 45-year old who had a $10,000.00 accrued benefit discounted at 9 percent with mortality, like the plan did, that is the 13,000, the opening balance.

THE COURT: So I was trying to think of the plaintiffs' position is that if you took the same 10,000 and you discounted it at the GATT rate in effect at that time, it would be 6.06 versus 9 percent, then you'd end up somewhere north of the 13,000. Is that right?

THE WITNESS: If you discounted the GATT rate and it earned how much?

THE COURT: Well, you discount at 6 point, GATT rate of 6.06 percent?

THE WITNESS: The opening balance is higher.

THE COURT: The opening balance is higher, and then it would remain higher as the 6 percent is added to it and it

would remain higher than the one year treasury rate? I am adding another column. If I add another column --

THE WITNESS: There is actually another chart in the report that sort of goes through that. I think it is pretty well right after this one. I took someone who is --

MR. RACHAL: Page 20.

THE WITNESS: In general, I think you're right that it depends on the age and how long one is in the plan in terms of whether it would catch up. If the person is young enough and treasury rates stay at the rate they're at, eventually it would catch up and exceed. Here I did something a little different. I have determined the opening -- how old this person was, I think was --

MR. RACHAL: You have your report there, too.

THE WITNESS: Let me find it in my report.

THE COURT: 45, 15 years of service, right, Paragraph 46?

THE WITNESS: Now we are on to 49.

MR. RACHAL: 49, your Honor.

THE COURT: You don't carry it through the same age assumptions? Oh, 50 rather than 45, I see, Paragraph 49.

THE WITNESS: This person, in fairness, this person now does have the enhancement, so this is sort of showing what the combination of opening balance is, actual opening balance with 6 percent interest. You see the 36,163?

THE COURT: Yes.

THE WITNESS: That is the opening balance at 9 percent but with the enhancement that this person would be entitled to at age 50, okay?

The person is aged 50 and had 15 years of service. This person, so with the enhancement, this person would have a $36,163.00. That would earn 6 percent interest a year. You see what those numbers look like?

MR. GOTTESDIENER: The right column doesn't have the enhancement.

THE WITNESS: I didn't say that. I haven't gotten to the right-hand column yet. The right-hand column is saying okay, what if the opening blance were determined at 6 percent, but as Mr. Gottesdiener has said, without the enhancement.

So just to sort of say okay, what is the effect of just changing without introducing the enhancement in that column, the theory here is that, look, on the left column it is a given we have the enhancement because that is the plan, 9 percent opening balance with enhancement. That is the actual plan.

On the right side I said okay, if the opening balance was determined at 6 percent, there is some real question as to whether an enhancement would be necessary or appropriate because the opening balances are so much higher. 44,000, you see the opening balance even without enhancement is 44,000

compared to 36,000. It is quite a bit higher than the actual opening balance for the person with an enhancement.

So then I said all right, what if we take that 44,423 and take that and invest it in the open market, and then you see it crosses over at some point, it takes about 10 years. It starts off with a plan that is lower. Again the 6 helps.

It is a package. This is the way plans are generally designed. They're designed with a lot of moving parts. The package here is the 9 percent opening balance discount rate, the 6 percent interest crediting rate and the enhancement.

What I am suggesting is that another package might have been a straight 6 percent opening balance and the plan might have actually credited one year treasury rates. There were a lot of plans, particularly early on, that credited the most popular rate, and this comes again from that survey, the most popular crediting rate in the early years was either a one year treasury rate or variable would change each year, interest crediting rate, sometimes with a margin added on, half a percent, maybe up to a percent. So that is sort of the idea of this table.

THE COURT: Then in that survey you say that -- do you have your report with you?

THE WITNESS: Yes, I have it.

THE COURT: On Page 29 of that survey you say there is a block which says using high interest rates in determining

open balances, thereby causing the wear-away effect is not common practice. Can you describe that to me.

THE WITNESS: I would say that in most situations, the opening balance interest rate is determined using an interest rate which is closer to, not necessarily equal to, but closer to the 417 (e) rate, at or near the five-month period of the survey.

We looked at 417 (e) rates within a five-month period and then ranked them, how many plans had an open balance, which was higher or in that range or lower than the range, and the survey revealed that, you know, it had large segments, each were higher in the range or lower in the range, but there wasn't in the survey some tenancy to, you know, at least in many plans to, you know, to have that much or much of an initial wear-away.

THE COURT: All right. Thank you.

MR. RACHAL: Your Honor, can I take a one-minute break?

THE COURT: Sure.

MR. RACHAL: It will be very short.

THE COURT: All right. Go for it!

(Recess)

BY MR. RACHAL:

Q. I'll shift topic a little bit. What was the 417 (e) rate based on prior to the 2006 -- excuse me -- Pension Protection

Act?

A. Well, it varied by the time. Before 1985 there was no 417 (e) rate. The rates just had to be reasonable like any other assumption.

Then starting in it was I believe 1985, the one set of rates came into being, the BBC rates and in '91, '95, the 30-year treasury rates were incorporated into the 417 (e).

Q. What happened with the 2006 Pension Protection Act?

A. In the 2006 Act, Congress changed the 417 (e) rate from the 30-year treasury rate to what we're calling for simplicity corporate bond, the corporate bond rate.

Q. I know you referred to this report. What was your understanding of why Congress was making that change?

MR. GOTTESDIENER: Objection, your Honor.

THE COURT: I'll allow it, but ultimately obviously he is not seeing into the mind of Congress. I assume he has a basis for it based on legislative history which I can also read. To short-circuit that, let's hear his version.

THE WITNESS: Well, based on, to some extent based on legislative history and to some extent based on my understanding of what was leading to the change was a concern that many had, particularly in the employer side, saying the 30-year treasury bond rate was providing too low of an interest rate, something like when they adopted the corporate bond rate would make more sense.

BY MR. RACHAL:
Q. Based on the actuarial consulting experience, during the mid-1990's did employers consider the 30-year treasury rate to be the correct rate to convert annuities to lump sums?
A. Well, it was correct in the sense of that is what the law required, but it was not something that employers felt --
MR. GOTTESDIENER: Objection, your Honor.
THE COURT: Overruled. All of this is not based upon his speaking for the employers. It is based on his experience in assembling information, so it is appropriate.
You can continue.
A. Yes, based on my experience with, talking with employers. Sometimes it was just talking with employers who were considering putting a lump sum option in their plans. When they saw what effect that would happen on their costs, they, a lot of them backed off. They felt that a 30-year treasury rate cost of the plan, payout 30-year treasury rate, it would cost the plan too much money.
BY MR. RACHAL:
Q. Based on your discussions with those employers, when you advised employers during mid-1990's, did they have concerns interest rates would be rising again?
A. As I said before, some of them, at least some of them had, definitely had that concern, most of them I dealt with.
Q. What about during the 1995-1996 period, what was the

30-year treasury rate doing during that period?
A. I know at the end of 1994, the 30-year treasury rate was up close to 8 percent. I think it was actually over 8 percent very late in 1994.
Then during 1995 it started to reduce, so it was up around 8 percent, started to reduce. Part of the way through the year, especially during the end of the year it reduced pretty rapidly and ended up about 2 percent, just about 2 percent lower than it was the year earlier.
Q. What happened in 1996, do you recall?
A. In 1996, in the first six months of the year, it was down to 6.06 percent, had increased in June, six months later, by exactly 1 percent, up to 7.06 percent.
Q. Did this interest rate volatility indicate any market uncertainty to you?
A. Well, it certainly is volatile. I guess along with volatility, it is an indication there is some uncertainty in the markets, I guess I would agree with that.
Q. Did the use of the 30-year treasury rate confer any financial advantage to the class members?
MR. GOTTESDIENER: Objection. Your Honor, this was required by law.
THE COURT: What is that?
MR. GOTTESDIENER: It was required by law.
THE COURT: That's all right. He can answer.

A. Well, I think certainly it does. Just because the law requires something, in my view, it doesn't necessarily convey more than an appropriate economic value.

I think that again many employers felt -- and as an actuary I was inclined to agree with it -- that the 30-year rate was a generous, 30-year was a generous rate. So in that sense I would say it did convey value that was more than the value that I would attribute to the annuity that it was replacing.

Q. Did you analyze when class members terminated?

A. Yes.

MR. RACHAL: Would you pull up DX-411. I am sorry. It is not 411. Yes, it is DX-411.

BY MR. RACHAL:

Q. Do you have that in front of you?

A. Yes.

Q. What does this graphic show?

A. This shows among the 16,411 members, that about two-thirds of them had terminated employment in the first three years after the conversion, '96, '97 and '98.

THE COURT: Does this number include those individuals who would have received lump sums by virtue of that $3,500 rule that we talked about?

THE WITNESS: Yes. We're starting with all, this is all the members who terminated in those years. So the 11,000,

there are just talking about the 11,000, that is all of the employees or the class members who terminated employment in those three years. That is why we haven't made any -- there is no distinction through what they've done.

THE COURT: You may proceed.

BY MR. RACHAL:

Q. During this period in which the participants were receiving lump sums, electing on par with those for values under 3500 cash-outs, what was the 417 (e) rate that was applied assuming they were in wear-away?

A. The 30-year treasury rate.

Q. What did that mean for this group as compared to the corporate bond rate applied during that period?

MR. GOTTESDIENER: Objection.

THE COURT: Overruled.

A. That means they value the present value, lump sum present value of their frozen protected benefits would have been lower using a rate that might have been one and a half percent or so higher than the Treasury rate.

BY MR. RACHAL:

Q. Do you consider the 9 percent rate used to set the opening balance to be an actuarially reasonable rate?

A. I do.

MR. GOTTESDIENER: Objection.

THE COURT: Overruled.

BY MR. RACHAL:
Q. Is there any one definition of actuarially equivalence used in the actuarial profession?
A. No.
Q. Is there anything that the actuarial standards and practice require on actuarial equivalence?
A. Not that I'm aware of.
THE COURT: By how much can it vary? I'll just leave it at that.
THE WITNESS: It depends on the purpose for which you're determining an actuarial equivalent. In all cases, you know, one needs to look at what it is you're trying to accomplish by making the actuarial.
Once you do that, there is still variation. In my view, there is a judgment element that if you ask five different actuaries what they think is reasonable, many of them would either come up with a particular number or give you ranges, this is a range of reasonableness, but again the purpose of the measurement is critical, what you're trying to accomplish.
Sometimes there is actuarial equivalent that is set by law, you have no choice, by 417 (e), and that's using 30-year treasury rates using lump sums. You can characterize that as an actuarial equivalent in a sense even if some of us feel it was overpaying people. In a sense it is actuarial equivalent

because the law requires it.

THE COURT: What does actuarial equivalent mean?

THE WITNESS: It is usually used in the context of converting one form of pension benefit to another, and it is used -- for example, many plans until -- many plans going back a ways, when a lot of them were insured, insurance companies provided the benefits, they would have an actuarial equivalent rather than having like Foot Locker has early retirement, where they have 4 percent per year scale like that, they would have a scale that varies.

The difference in each year is a little bit different and that would be based on some type of interest rate and mortality assumption, and the idea there was they're trying to protect, protect their interest. They don't want to subsidize anything at least knowingly.

So then we have this flat rates of 4 percent or 6 percent a year. In a sense, in a broad sense those can be viewed as either actuarial equivalent -- maybe a steeper scale is closer to an actuarial equivalent. The 4 percent is subsidized to an extent. So the term "actuarial equivalent" is used in different ways, but it is to convert one form -- some might convert a life annuity to a joint survivor annuity.

THE COURT: What is on the other side of the equal sign?

THE WITNESS: You start off with a thousand dollars a

month life annuity at age 65, and the plan has, and the Foot Locker plan has factors that are referred to that convert that thousand dollars. You only get $9,100.00 a month as a joint and 50 percent survivor annuity.

So to a spouse, a thousand dollars they're paid while I am alive, $910.00, and then half of that after I die, my spouse is still alive, she receives half of that for the remainder of her life.

Those are meant to be or characterized as being actuarial equivalent to one another. What does that mean? That means if things on average work out, the plan will pay about the same amount of money out on one form versus the other. It is neutral from the plan's perspective. The plan is not expected to gain or lose from that transaction.

Will they gain or lose on an individual? Yes. It depends on how long people live.

THE COURT: So actuarial equivalence ought to be neutral from the plan perspective?

THE WITNESS: That is certainly one way to look at it.

THE COURT: Is that the most common way?

THE WITNESS: That is the way it originated.

I would say from the plan's perspective, actuarial equivalent is supposed to be neutral or close to neutral from the plan's perspective, so the plan would not care, and it shouldn't make any difference in their costs at least over the

long run.

Now then the question is, you know, what about from a participant's perspective, does the participant have a different perspective on all of this? The answer is maybe. The participant may view an actuarial equivalent differently than a company would because it is their benefit. It is their finances. It is what do they think is fair and appropriate.

So from my perspective, there is a certain balancing act, there is judgment, and I think there is leeway as well. A company, you know, that is, you know, companies that are in real good financial condition might say well, let's determine opening balances and be more on the generous side. If we think 30-year treasury rates are too low, we'll do it that way anyhow and it will cost the more money than it otherwise would, but we can afford it. They'll do that or trim back other features of the plan.

It is all what can you afford, what is reasonable, and there is a lot of judgment, in my view.

THE COURT: Thank you.

BY MR. RACHAL:

Q. At the time of the Foot Locker cash balance conversions, were there any legal requirements on how a plan can calculate the opening balance?

A. I would say there was no explicit legal requirement.

Q. Was the addition of lump sums using the 9 percent rate to

set the initial account balance, in fact, cost-neutral for the Foot Locker plan?

MR. GOTTESDIENER: Objection.

THE COURT: I'll allow it. You may answer.

A. I think the intention, seen from reading through the documents --

MR. GOTTESDIENER: Objection.

THE COURT: Overruled.

A. -- that what I read, how I interpreted it, the documents, was that the intention was to tie it to the expected return on plan assets was to settle the balances to provide a cost-neutral effect.

There ought to have been some anticipation that, indeed, they would have to pay out lump sums at least in the short run, and maybe in the long run that are, you know, that are based on 417 (e) rates that are below 9 percent.

When in 1996, in the first year the rates were 6 percent, it turned out not to be as cost-neutral. It turned out not to be cost-neutral in those years and in subsequent years it ended up costing money, as we have seen in the samples.

Q. To kind of close the loop on that, why did it cost the plan money during that period?

A. Because at least for the people, which is most of the people who were in wear-away, when they took lump sums, they

received those lump sums based on the frozen protected benefit discounted at the 6.06 rate, the statutory 30-year treasury rate versus the liability that was being held for them at a 9 percent rate.

THE COURT: We can break for lunch whenever is a good time for you. We don't have to break now. We can break in 10 minutes, but just be aware we'll break certainly by 1:00 o'clock.

MR. RACHAL: I have five questions that probably will --

THE COURT: Sure. Absolutely.

BY MR. RACHAL:

Q. Based on your review of the documents, did Mercer recommend using the 9 percent rate to set the opening balances?

A. That's what seemed pretty apparent to me that they did.

MR. GOTTESDIENER: The same objection, your Honor.

THE COURT: I was waiting for the objection. You should leap to it.

MR. GOTTESDIENER: Sorry, your Honor.

THE COURT: That is okay. I don't want him to be testifying just about what the meaning of the documents are. If you want him to have him apply his expertise, that is a better way to use his time. Let me strike the last answer.

BY MR. RACHAL:

Q. Based on your review of the record, was Mercer's

recommendation to Foot Locker on how to set the opening balance reasonable?

MR. GOTTESDIENER: Objection.

THE COURT: No. That is certainly appropriate. You may answer.

A. I think it is, yes.

BY MR. RACHAL:

Q. Why is that?

A. Well, I assume we are talking about the recommendation being 9 percent. I think that again this design was the first item, the first objective was saving costs. I think there is a range of reasonableness for actuarial equivalence.

I think it is reasonable for the actuarial equivalence to be set at the plan's expected rate of return. That is what they did. They certainly could have used a lower rate. It would have increased costs if they did. Increased costs means that something else either would have had to accept the increased costs or they would have had to find something else in the plan or elsewhere to offset it.

MR. RACHAL: Your Honor, this would be a good breaking point.

THE COURT: Thank you. Let's take our lunch break and we'll come back at 2:00 o'clock.

(Luncheon recess)

(Continued on next page)

A F T E R N O O N S E S S I O N

(2:05 p.m.)

THE COURT: Mr. Rachal, you can proceed whenever you're ready.

MR. RACHAL: Thank you, your Honor.

I just had one quick housekeeping. We are going to go ahead and withdraw Demonstrative Exhibit 434. It's 434-2. It's basically a graph. It's this one in the back and the table that goes with it.

We are going to withdraw it.

THE COURT: Thank you.

That's withdrawn.

BY MR. RACHAL:

Q. All right. Going back to the 9 percent interest rate that was used to set the initial account balance, how did that 9 percent rate compare to historical rates?

A. Well, looking -- I know I looked at a couple of different periods in my report. I think it was 15 years and 20 years I'm pretty sure.

MR. RACHAL: We can go ahead. Let's go ahead and pull up Exhibit DX 412. Thank you.

BY MR. RACHAL:

Q. Does this graphic represent the analysis you did?

A. Yes, it is actually 10 years and 15 years I wrote. So I looked at the average of the 30-year bond rates in the 10 years

ending through 1995. And that worked out to 7.9 percent.

And I looked at the 15-year average, which would have started from 1981 through 1995, and that worked out to 9.3 percent.

Q. Did you go back and look at the 30-year treasury bond rates since they first started publishing it I think in the '70s sometime?

A. I think it was February of 1977 when they first started publishing these rates, and the average was just about the same as the 15 year average, 9.3 percent.

Q. I know you talked about this earlier. Does this graphic illustrate what was occurring with the 30-year treasury bond rate in the '95 period when the cash balance plan was designed?

A. Yes, it does.

Q. What does it show?

A. It shows the rate at the beginning of the year, which was based on a December 1994 rate, which was 7.87, and then it dropped by the end of '95, December of '95, to 6.06 percent.

Q. What was the expected wear-away under the 7.87 percent rate when the cash balance plan design began?

A. Based on the record, I think it was Mr. Kiley's notes, one of them, there was an indication and I think -- I'm pretty sure that it came from Mercer, they expected about a two- to three-year wear-away period.

Q. Was that an average or was that the total period, expected

period?
A. I'm not sure what it meant. It said two to three years, so I would presume that it might have been an average.
THE COURT: Did you do any work yourself to confirm one way or the other whether or not that was a reasonable expectation for wear-away, given the various factors that were in play with respect to this plan and the number of participants, etc.?
THE WITNESS: I don't think, your Honor, that I did anything in -- indicated any of that information in my reports.
THE COURT: Did you just accept that was their going-in view as to the expected duration of wear-away?
THE WITNESS: Well, I have done -- subsequent to issuing my reports I have done some -- you know, it's been three years. So I looked at that, and I think I pretty well confirmed that on average it was two to three years or something just a little bit longer, and some at that rate had none or virtually none, especially with people with enhancements.
THE COURT: All right. Thank you.
BY MR. RACHAL:
Q. Mr. Sher, did you do any analysis to determine what the corporate bond rates that were later approved by Congress would have been during this period?
A. Yes. Yes, I did.

MR. RACHAL: DX 413.

Q. This graphic, does that report your analysis of what those corporate bond rates would have been?

A. Yes, it does.

Q. What were you finding on the corporate bond rates during this period, the difference between them and the 30-year treasury rate?

A. That the spread between the two was about one and a half percent, focusing on, again, for opening balance purposes, the vast majority of the people I think it was 70 percent were age 45 or under. And that spread would be applicable for that group of people, for the majority.

Q. Did the addition of the enhancement impact your views as to whether the use of 9 percent rate with the initial account balance was reasonable?

MR. GOTTESDIENER: Objection.

THE COURT: Overruled.

A. As I was saying before, I think, at least in my experience when I look at designing these type of plans, any retirement type study, you look sort of a combination of the impact of the various elements, so I would look at a package like this and believe that the actuary and those who were considering it would look at the package as a whole.

Q. What was the impact of the enhancement on the group that qualified for the enhancement vis-a-vis wear-away?

A. These were the people who were age 50 with at least 15 years of service on January 1, 1996. Their opening account balances determined, otherwise determined would be increased up to 67 percent for those who were 55 and under. So between 50 and 55 would be a 67 percent increase, grading down as you go through the period from 65, from ages 55 through 65.
Q. I have some final questions relating to this topic.
It's correct that in 2000 your firm, I think it was PricewaterhouseCoopers conducted a survey of cash balance plans, the one you referred to earlier?
A. Yes.
Q. That survey is attached to your report. I think Judge Forrest has it. Everybody has it.
A. Yes.
Q. I think you were asked earlier, it's correct you don't know whether the Foot Locker plan was included in the survey?
A. I do not know.
Q. Did this survey include any information on the spread, if any, between the 417(e) rate at the time of conversion and the discount rate used to set the opening balances?
A. Yes. What it actually did is it looked at the range of 417(e) rates in the five-month period before the plan's conversion date, and then compared that range to the actual opening balance interest rate and then ranked the plans as to whether they were within the range, below the range, or above

the range.
Q. What did your survey find on this issue?
A. In general, it found that there were a good number of plans that had rates that were within the range, above the range, and below the range.
Q. For the period from 1995 forward after the 417(e) rate, the 417(e) basis was a 30-year treasury rate, how many plans in the survey were more than 2 percent above that rate or that range?
A. I believe there were two out of -- I think it was -- it was 4 percent. 2 out of 52 I think.
Q. Was it correct that Foot Locker's spread was 3 percent?
A. No. Their spread -- when we are looking at the spread, we are not comparing the interest crediting rate to the opening balance interest rate. What we're comparing is the 417(e) rate during the five-month period to the opening balance rate.
When you look at that, I think it's 2.1 or 2.2 percent above the range.
Q. Is Foot Locker an outlier on the spread based on these survey results?
A. I would say certainly on its face it would seem that way.
Q. Is there anything that would qualify your views on this?
A. I think there are two things. One is I think I mentioned earlier that this was a period, as we've seen, where rates, rates had been coming down just about 2 percent from the beginning of '95 to the end of '95.

And I know that and the survey shows that when rates are at a low end, which I think people perceived they were at that point in time compared to all the history that we're looking at, there was a tendency to sort of discount at least to some degree the recent reduction in rates, a tendency therefore to use a rate that's somewhat higher than the 30-year bond rate.

The other element here, and this is something that I don't usually like to admit, but I think the survey was somewhat flawed, and was a correction made in the later survey. The five-month period look back, I think was too short for many companies, especially for Foot Locker, but for many companies, not just Foot Locker.

We found and I found, you know, looking back at how long it takes companies to get from the point where they pretty much make a decision and now they are just working out the details, the administration of the plan, the plan documents, whatever else, communication materials and finalizing, putting the final touches on the design, it takes at least six months, in some cases, like Foot Locker, closer to a year.

So I think that that period was too short, and actually the next study that we did when I was at Mellon, which was a follow-up study, used a nine-month look back period because, again, we thought at the time that was more realistic, even though I think that's still a little bit short for many

companies.

MR. GOTTESDIENER: Your Honor, we don't have this study that he's talking about. I would object.

He didn't supplement his report.

THE COURT: You can cross-examine him on whether it exists. Don't people talk about all kinds of things as part of their expert testimony, not all of which has to be provided.

It had not been mentioned before?

Have you not mentioned this study before?

THE WITNESS: I don't think I did, no.

THE COURT: Why did you include the survey that you included as an attachment to your report if you thought it had some flaws?

THE WITNESS: Well, I don't think I was focusing so much on this section of the survey in my report. I think it was focusing on a different section.

Then plaintiffs pointed out I think it was maybe in Mr. Deutsch's rebuttal report, you know, that section of the survey, and afterwards I took a look at it, and I realized that I had done a later survey.

The reason I included the earlier survey is because I wanted to, I thought it was more appropriate to include the data that was closer in time. I didn't really want to include conversions that occurred after 2000. So I thought the earlier survey would be more appropriate in this case.

THE COURT: The version of the survey that I have attached in color to your declaration -- and we will be clear, it's your first report. And the date, so we're absolutely clear about it, it is the last page of the first report, May 10, 2012. That version has what looked to be nonoriginal highlights in green in various places.

MR. RACHAL: Your Honor, I will confess those are my highlights.

THE COURT: All right. OK.

I took these as pieces of the report that you weren't disavowing certainly, and in particular, turn to page 28.

THE WITNESS: Which document is that in?

THE COURT: Which what?

THE WITNESS: Is that attached to my report?

THE COURT: It should be. It's attached to my version.

THE WITNESS: OK.

MR. RACHAL: Do you have it?

I should have an extra copy if you don't up there.

THE WITNESS: That's DX 12?

MR. RACHAL: Yes.

THE COURT: This survey.

THE WITNESS: I don't believe it's -- at least it is not attached. There is a page that says appendix 3. That's the last page of that document.

THE COURT: It's table 10-B, which is what I'm looking for.

THE WITNESS: I know I don't have it here.

THE COURT: Let me just show you mine.

THE WITNESS: OK.

THE COURT: Let me hand this over. I don't know, Mr. Gottesdiener, if yours had the green on it or not.

MR. GOTTESDIENER: No, your Honor.

THE COURT: But attached to mine, and then I will show it to Mr. Gottesdiener, you will see that there is some green highlighting on that page 28.

Do you see that?

THE WITNESS: Yes, I do.

THE COURT: That's not yours?

THE WITNESS: No.

THE COURT: All right.

THE WITNESS: No, it's not.

THE COURT: I think Mr. Rachal has represented that it's his.

That page and then the page or two after that, which relate to interest rates, is that something that you now think is not as relevant to Woolworth, or do you think that it's still relevant to your discussion here?

THE WITNESS: Well, I think, given that I changed it, we changed it in the next survey, we changed an element of it,

which changes the relationships to some degree, I think in retrospect, we did not do it the way we should have done it.

THE COURT: All right.

Mr. Gottesdiener, have you seen the green highlights.

MR. GOTTESDIENER: No. I was just wondering for the record if maybe the Court can put in the page and the lines.

THE COURT: Yes. It's page 28. It's the last three, four, and five lines on the page, starting at "When prevailing rates."

It skips the next line and then picks up.

Then on the next page, it's on page 29. There is a green circle around the first two interest rate ranges where the number 8 and the number 10 are in the fourth column over.

Then there's highlighting throughout that paragraph. There are a few other places in this where there's highlighting as well.

All right. You may proceed, Mr. Rachal.

MR. RACHAL: I just want to note, too, for the record that the one that was ECF filed unfortunately has the green highlights. You can find it there. It goes from docket 338-13 to about 338-32. It had a lot of highlights.

THE COURT: All right.

MR. RACHAL: That's the one that is ECF filed, so counsel also has had access to the highlights.

THE COURT: All right. That's fine.

BY MR. RACHAL:

Q. Based upon looking at a longer look back period during the plan design process, how does Foot Locker's interest rate that it used with the starting balance compare with that longer look back period?

A. It lowers it. The amount above the range comes down to under 2 percent, between 1 and 2.

Q. In your view, was it actuarially reasonable to discount the initial account balance for mortality?

A. Yes.

Q. Why is that?

A. Because what you are taking is a normal retirement annuity. That's how it's defined.

You take the accrued normal retirement annuity, and you convert it to a present value at the conversion date based on the employee's age at that time.

There is a real probability that between that age at conversion and age 65 that the employee will not survive, just like there is a probability that he or she won't survive between age 65 and 66, 66 and 67 and so forth.

Q. What does that preretirement mortality discount reflect?

A. It reflects the probability that the person will not make it to age 65 when he or she would have been entitled to commence a normal retirement benefit as an annuity under the prior plan.

Q. Are there tables used to make this mortality discount?
A. I'm sorry. Are there tables used? Yes, mortality tables.
Q. Yes. Let me ask you more directly.
Does the IRS publish a table used to make this mortality discount?
A. Well, they publish tables to make mortality discounts for Section 417(e). I believe that those same tables were used to determine opening balances. Actually, it is a table. It is a single table.
Q. Does the IRS mortality table for 417(e) distinguish between pre- and postretirement mortality?
A. No, it is just a table that has rates, you know, by age, at all ages, you know, from very young ages to very old ages.
Q. Other than death obviously, are life events reflected in its mortality tables, such as leaving work, retirement, that type of thing?
A. No, it's just by age.
Q. Did you see the IRS mortality tables referred to in the plan communications?
A. Yes, I saw some mention of them in the plan communications.
Q. Do you recall where?
A. I believe there is a mention in the SPD, and I think in some other communications as well.
MR. RACHAL: Jon, pull up DX 405 again.
Now I am going to switch. We are finished with point

two, and I am going to switch to point three, whether Foot Locker's communications were consistent with mainstream practices at the time.

BY MR. RACHAL:

Q. As part of the PricewaterhouseCoopers survey that you were talking about earlier, did you survey communications on cash balance conversions over the period in which Foot Locker converted its plan to a cash balance plan?

A. Yes, the survey included certain information on that.

THE COURT: Did you obtain as part of that information the average educational level of the participants in a given respondent?

So, there's an employer, it responds to the survey. Did you obtain any information relating to its population as regards educational level?

THE WITNESS: No.

Other information regarding the company, but I don't recall, I don't think we did that, no.

THE COURT: Let me just be very blunt about what I am trying to figure out when we get into this, because this came up when I was reading through it in your report.

One of the points of the communications is to convey information to the participants, is that right?

THE WITNESS: Yes.

THE COURT: The ability of a participant to understand

that information would depend logically in part upon his or her level of sophistication?

THE WITNESS: I think that's true.

THE COURT: So I guess the question is, in terms of the relevance of other employers who may have demographically similar populations, I understand the relevance of how they communicated something to a demographically similar population, but I am not sure that there would be as much relevance in terms of employers communicating to a differently constituted population.

Do you see my point?

THE WITNESS: Yes.

I am not sure where that leads in terms of how we change the communications approach, but --

THE COURT: Well, it depends on your view as to what the obligation is I suppose.

THE WITNESS: Right.

THE COURT: But let's assume for the moment that you have a sophisticated high-tech employer. One might view that group of employees as better able to comprehend certain communications.

Would you agree?

THE WITNESS: I would agree.

THE COURT: That would be in contrast perhaps to an hourly warehouse worker who might not understand things at the

same level without additional explanation or wording, further explained in some manner?

THE WITNESS: Yes.

But I would like to add to that. That is, in my experience when employers, when you have an organization where there is a lower level of understanding perhaps, they have to make a choice.

The choice is, do we provide more information that might have some chance of being really understood and not misused, and that runs the risk of, it is going to be hard to explain this. It's very complicated stuff, which this is.

Or, do you communicate to them -- or it can turn them off from reading it entirely if it gets too complicated. You're trying to explain it, but it's just complicated stuff. It is hard to explain.

Or, do you just explain to them sort of the more rudimentary things and then say, you know, if you really need help go get it?

Because it's going to take a sitdown. It's going to take sitting down with someone or really a meeting where it's explained very carefully these concepts that, you know, especially in broad-based communications are very hard to get across.

THE COURT: So to figure out where you want to fall in that spectrum -- let me put it differently. In your experience

advising different employers on -- let me ask you starting from before that.

Did you ever advise any employers plan communications?

THE WITNESS: I would say that I reviewed the communications and made suggestions. I do not consider myself a communication expert, but I have seen a lot of different communications a lot of different styles. Some of them getting much more complex and some of them more basic. It's really -- I think it comes down to a style that some employers are much more, you know, want to get more involved and really get into details and others have the philosophy that it's just not going to be, you know, they are going to pick it up and they're going to put it down.

THE COURT: Now, in regards to the comments that you would make on employer communications, did you consider the audience, and by the audience I mean the participant group who would be reading them when you were making your comments?

THE WITNESS: I would say yes, if I felt that the participant group was clearly sort of the two extremes that you articulated, where it was clear that there are, you know, that a good portion of their workforce was either very capable of understanding, very technical maybe an engineering company, where, you know, the people are going to tear it apart and they're going to figure it all out one way or the other, they are going to get to the bottom of it; or if it was a company

that had, you know, I don't want to say sixth grade or whatever, eighth grade level. Yes. I think that -- I think that most of the HR people that I've come in contact with were sensitive to, OK, who are we communicating to. And certainly the communications experts either internally or that they used consultants on the outside, I mean, I would think would have been in tune with that, who's the audience.

THE COURT: All right.

So then let me circle back now to where I started at the beginning, which is, in terms of the survey and the companies encompassed within the survey, do you have sufficient information to relate any of their populations to the Woolworth population?

I don't want you to speculate, but I'm trying to figure out if we've got apples to apples here or whether or not it is a hodgepodge of fruit, some of which are grapes and some of which are nectarines, and there may be an apple thrown in, but we are going to have to dig for it.

THE WITNESS: When we did the survey, we did not try to get that kind of information or try to record it. There are a lot of things in the survey that in retrospect, cross-relationships is what we are talking about here, that people have come in and said why did you do this or could you have done that. And the answer in almost all cases is, yes, we could have done that. We also wanted to get it done and

published, and we wanted to sort of get some basic information out there on what the practices are, hoping that people aren't going to take it and run with it, but they might get some value out of it when they're they themselves are going through one of these conversions. That's what we were trying to do.

THE COURT: All right.

Well, in light of that I have to say I am not sure what relevance the industry practice as associated with the survey will have in terms of direct relationship to the adequacy of the communications here.

With that said, I am going to let you develop your testimony, but I just want to give you a heads-up that I do view the communications as needing to be provided to a particular demographic. If we don't have a correlation between demographics, I can't really use it.

To the extent -- but go ahead and develop it and then you folks can make your arguments as you see fit afterwards on this particular point.

MR. RACHAL: Yes.

THE COURT: All right.

MR. RACHAL: Your Honor, with that qualification, I'm mainly using the survey to show what the practices were, not whether they were correct or wrong or right or --

THE COURT: I understand.

MR. RACHAL: Yes.

THE COURT: I just think if the practices were different for a different population, they may or may not be translatable here. But we can argue that.

Why don't you go ahead. I am not going to preclude you. Go ahead and develop that testimony.

MR. RACHAL: I will just have a few questions on it that will simplify it.

BY MR. RACHAL:

Q. What did the survey show regarding communications practices related to wear-away?

A. The survey focused on ongoing what I would characterize as annual, usually annual benefit statements, annual benefit statements which are similar to the ones that we have seen in this case, where each year they provide an update on the progress of the benefits that are being earned under the plan.

The survey showed, I think it was for a pretty significant majority, that in those annual communications what was highlighted was the cash balance benefit. And that while there were some companies that included some information on the frozen protected benefits or for that matter on other minimum benefits that go beyond the frozen protected benefit, beyond the requirement of the law, that most -- that the vast majority did not provide any of that information. Some of them did provide some degree of information. That's what the survey shows.

Q. Did you discern or did you collect data on whether there were any differences on the type of companies involved that had different types of information they were providing on this?
A. I don't think so. I think that it was either did you provide information on the any grandfathered benefits or minimum frozen type benefits on those benefit statements, just any information, and then the answer was either yes or no.
We didn't try to get into, at the time, you know -- obviously in hindsight it would have been nice to have a survey that for those who did provide information to get some indication as to what information they provided, but we had to draw a line. You ask too many questions and what happens is you get no answers.
Q. Did these communication practices --
THE COURT: Can I have you hold on for one moment.
MR. RACHAL: Sure.
THE COURT: I just want to read the answer.
I just want to be able to condense down what you have said, but I don't want to change what you have said.
All right?
THE WITNESS: OK.
THE COURT: Are you saying that in the companies with which you're familiar and that have undergone cash balance conversions and you were familiar with their communications that they did not typically provide specific information on

wear-away?

THE WITNESS: Well, I think -- I don't think I've said that yet. I think what I was focusing on, at least for now, is the survey. I can get beyond that.

THE COURT: Let's stick with the survey.

In terms of the companies included in the survey, is it your view that their communications relating to the cash balance conversion did not typically include information on wear-away?

THE WITNESS: I think the survey question was focusing on, not on the information at the time of the conversion, but the information on an annual basis after --

THE COURT: More like the retirement summaries or benefit summaries that an employee might receive, is that right?

THE WITNESS: Yes, once a year typically.

And I think that is what happened at Foot Locker. Once a year they would get an updated statement or -- it can be either a pension statement by itself, it could be embedded within a broader based employee benefit statement. That would have information on the progress of their pension benefits.

Those were the kind of, you know, continuing periodic communications that the survey was focusing on with regard to wear-away.

THE COURT: Did you separate those into buckets or

piles, if you will, as to the companies whose cash conversion resulted in effectively no wear-away versus those where the formula resulted in wear-away, or were they all grouped together?

Do you understand?

THE WITNESS: Yes, I think they were all grouped together. I don't think there was a distinction in the survey among the different situations like that.

THE COURT: And is it true that in your view there would have been some of the cash conversions where the formula used would have resulted in no wear-away or at least nominal wear-away with that small fluctuation you talked about as possible?

THE WITNESS: Well, I would say in a number of cases there would have been little or no initial wear-away, but as you went through this period and interest rates declined, it allowed those situations where they didn't think they would have any wear-away and they suddenly had wear-away because the value of the frozen benefit went up as interest rates came down and the cash balance benefit stayed where it was, on the same track that it was on.

THE COURT: When you were looking at the communications that you have described, which were annual plan statements or whatever they were, do you have a sense as to where in that process some of those companies may have been?

In other words, whether they were in wear-away or not yet in wear-away or coming out of wear-away?

THE WITNESS: Not directly.

I mean, we did a survey in 2000, and we had a number of plans that had converted as early as mid 1980s, although there were some other plans that converted very recently, in the late '90s. So it was a mixed bag.

But, no, there was not an attempt to try to break it down like that.

Again, it was just, you know, not one of the things that was on our radar screen.

We were trying to get some basic information at the time.

THE COURT: Right.

Mr. Rachal.

BY MR. RACHAL:

Q. As a general matter, what type of companies were included in the survey? Who were you surveying?

A. I would say they were primarily larger type public companies, companies that were clients of ours and clients of, you know, not clients of ours, or companies that maybe where we designed, helped design the program, and some where other consultants designed the program.

But we managed to just gather information. Almost all of them would have been companies of two or three thousand

employees or more and some of them much more.

Q. Moving beyond the survey to talk about your experience, what you saw, your advice and such that you were doing on cash balance conversions in this period, what did you see companies do regarding wear-away, or at least what was your experience? I am talking about disclosures.

A. If we are -- let's first at least address maybe all you want to address is these ongoing annual --

(Continued on next page)

Q. I am talking about the conversions, the whole thing.
A. I would say that it varied, it varied, you know, on conversion it varied a fair amount in terms of what would be communicated. Sometimes again the communication -- the question is do you communicate this on some broad-based one or two or three page communication or do you try to communicate it in some other way, through group meetings, individual meetings.
You know, it varied, but I would say that, that once the employer understood how, just how variable, if there was a chance of wear-away, reasonable chance of it, of it occurring, there was a lot of companies there was reluctance to try to communicate that in some broad way other than to use something like I interpret what was going on here in the SPD, and that is your benefits can be subject to a minimum benefit based on the prior plan accrued benefit.
That was fairly common to have that kind of language, but getting into how much wear-away affect might be and how it might be affected by changes in interest rates or by people's pay levels and how long they work, there was a real hesitancy to get into that.
Q. Do you see these communication practices changed after Foot Locker's cash balance conversion, talking about as a general matter?
A. I didn't notice anything until Congress passed a law in 2001, and IRS regulations came out hoping to interpret that law

in 2003, having to do with changes to Section 204 (h) of ERISA.

Q. I might have some follow-up questions, but just as a general matter, what was that change? What did it require disclosures regarding wear-away?

A. Well, regarding wear-away, the guides in IRS is question and answer format, Question 11 that goes on for several pages. Essentially what it wants employers to do when it has one of these conversions is to provide a set of examples of people in different ages and service categories where it shows the effect of the amendment on people.

If there is a wear-away, the example should show how much wear-away there might be. That was essentially -- and then there can be some descriptive language along with that, you know, explaining, explaining it.

Q. Based on your review of the communication materials here, did Foot Locker disclose the prior minimum lump sum amounts post-conversion and compare them to the account balances?

MR. GOTTESDIENER: Objection.

THE COURT: Let me just see how this question is worded.

(Pause)

THE COURT: Overruled. I'll allow it.

A. If I understand the question, in terms of broad-based communications, I don't think so. They had these memos and Greenville and Phoenix and there were a bunch, bunch of letters

and memos that were introduced that showed that when it came down to an individual who has asked for numbers and were thinking about leaving or retiring in a given year, I saw certainly some information in that regard.

Q. Did you see any benefit estimates that provided that information?

A. Yes.

Q. Do you recall a GAO, Government Accounting Office, report to Congress around 2000 assessing cash balance conversions?

A. Yes, I remember that.

MR. GOTTESDIENER: Your Honor, this was one of the slides we had objections to because it is talking about 204 (h) as opposed to the SPD.

THE COURT: Don't spend a lot of time on it, but I'll allow it.

BY MR. RACHAL:

Q. There are two highlighted sections. Under current disclosure requirements, firms may have broad flexibility in the type of information they provide participants about plan changes. And then it goes down and it says, however, the law does not specifically require that plan sponsors articulate the nature of the formula amendment or identify groups of participants who may be adversely affected.

Is this consistent with what you were seeing about the plan communication practices prior to the change in 204 (h)

notice requirements?
A. I would say it is, yes.
MR. RACHAL: Go ahead to 415-2, the second page.
BY MR. RACHAL:
Q. The matters highlighted, matters for Congressional consideration, the parts that I have highlighted from Page 39 of the report are matters for Congressional consideration.
It says to improve disclosure related to pension plans, the Congress should consider amended ERISA so that it specifically requires firms to provide participants with more timely information, in plain language, about plan changes that can reduce future pension benefits.
This is consistent with what you recall on plan communication practices that were being changed because of 204 (h)?
A. I would say that this report was building the case that in GAO's opinion, some improvement in communications should be adopted by Congress.
Q. Did you form an opinion on what Foot Locker would have had to disclose related to wear-away had the changed 204 (h) notice requirements applied to it?
A. Well, again I think they would have had to show some examples illustrating it and perhaps some language discussing it. I think that one of the key elements in determining the potential amount of wear-away is what assumption is made in

terms of any of the variable rates that are embedded into a plan.

In this plan, the variable rate can make a huge difference in making comparisons, and the calculations under the plan is the 417 (e) rate. What Congress -- and this is brought out more subtle in IRS regulations that were finalized in 2003 -- indicate that the calculation should be made by determining the value of that variable rate at a period of time close to the time when 401 (h) notice is sent.

They basically said what's the plan rate that would apply at that point in time, lock it in and just do the calculation on that single basis. I am saying single basis because actually I was somewhat surprised that maybe they didn't go further.

I think out of practicality, they decided not to go further than that and ask for multiple scenarios where the rate might be 5 percent, 7 percent, 9 percent because the difference in the outcome can be very dramatic, but they didn't, they locked in on that rate.

Q. Why does Foot Locker, what was your opinion if this applied to Foot Locker? What does this --

A. The way I interpret the regulation, the rate that would have been in effect when the 204 (h) notice went out was the rate in effect for the year of 1995 based on the December 1994 rate, which was 7.87 percent.

Q. What would you have expected those disclosures to show on wear-away using the 7.87 percent rate?
A. Based on what we discussed earlier, the two to three year average, I would expect, depending upon the particular example, were examples were shown to see periods that were, you know, in two to three year range, maybe some shorter, some longer.
I think there would have been examples for people, where enhancement were shown, either none, virtually no wear-away.
Q. I will ask a little about SPD summary plan descriptions and discuss whether SPD discusses wear-away. You recall Mr. Deutsch's testimony he had not seen an SPD discussed in wear-away?
A. I do recall that, yes.
Q. Have you seen any summary plan descriptions discuss wear-away, this can be either pre or post the change in the law --
THE COURT: In light of the questions before, why don't you go back and build a foundation so you can do it and I don't need to.
MR. RACHAL: I appreciate that.
BY MR. RACHAL:
Q. Corrected as part of the plans for how long you have been advising for cash balance conversions, you reviewed a good number of SPDs?

A. Reviewed, made comments on, drafted some sections when I was called upon to do that, yes.
Q. Even behond your advising plans, do you look at SPDs related to cash balance conversions?
A. Yes.
Q. On any of those SPDs do you recall seeing any discussion of wear-away other than what --
MR. GOTTESDIENER: Objection.
Q. -- other than what you had mentioned about the kind of greater of provision?
MR. GOTTESDIENER: Objection.
THE COURT: Sustained. Why don't you rephrase it.
BY MR. RACHAL:
Q. On those SPDs, did you see that you reviewed and asked, do you recall seeing any discussion of wear-away?
MR. GOTTESDIENER: Foundation, your Honor; objection.
THE COURT: No. I will allow it. There is a missing piece of foundation. Let me sort of get to it. You understand?
THE WITNESS: Yes.
THE COURT: Were there instances when you were reviewing SPDs, when you understood -- I want to start differently from that. Take ourselves back to pre-law amendment, all right, so we are back in the world before the amendments that you were just talking about occurred.

Are you with me?

THE WITNESS: Yes.

THE COURT: We are back in the time-frame here most relevant here, which is sort of the '96 to 2000 time-frame, all right?

THE WITNESS: Okay.

THE COURT: In that context, do you recall whether or not there were companies that you were advising on their SPDs, whose participants, at least some of whose participants were experiencing wear-away?

THE WITNESS: Yes.

THE COURT: In connection with that, so let's take that so you have a group of SPDs you're reviewing, at least some of those have participants where there is some amount of wear-away, do you recall whether or not there was any disclosure or discussion of that wear-away?

THE WITNESS: I would say --

THE COURT: I want to make sure so you understand, it is a pretty narrowly focused question.

THE WITNESS: Yes. I would say I have not seen anywhere -- let's keep it to that time-frame for now, as you wished that used the term wear-away.

There are, I would say, many of them did have language in the SPD that said something to the effect that in the event that the benefit accrued under the prior plan as of the date of

conversion, whatever that day was, provides a higher benefit, it will be entitled to the higher benefit. They did it in some way or another somewhere in the SPD.

Sometimes it was right in the forefront, right when they're describing the formula. Sometimes it was later on when they're talking about general kinds of things. It is kind of -- and in the event that the prior plan frozen benefit comes, works out to be more, you're entitled to more.

THE COURT: That sounds somewhat similar to what we're talking about here in connection with the SPD language here?

THE WITNESS: Certainly the way I would read that language, at least the language as intended, it may not have been the best language in the world, but it seems like it was intended to convey that, that there is this 12-31-95 benefit.

If there was no chance of that benefit being larger, there would have been no reason for that in there. By virtue of it being in there, in my experience, I would only suggest that someone put it in there if there is going to be any possibility of it being applied.

Otherwise, it will be really --

THE COURT: Let's take it one step beyond that. I understand that language may have some, shall we call it, conceptual overlap with language you saw in other SPDs relating to or distributed by companies that had some participants in wear-away.

Do you recall whether or not any of those SPDs discussed whether or not in certain situations that would mean that additional periods of employment would not increase the frozen accrued benefit, or that their frozen accrued benefit might mean that their work since the time of conversion had not resulted in a growth in their benefit?

THE WITNESS: Yes.

THE COURT: There is lots of ways to word this.

THE WITNESS: I understand. No, I don't recall seeing any of them put it in that way. I can understand why they wouldn't want to put it that way.

I would probably recommend they not put it that way. I think that is confusing. I think in these cash balance plans the focus, the sort of center of the universe is the account balance. It is the only thing that is guaranteed, it is the only thing they know for sure is going to keep growing.

This other number while at any number given point in time, this froze benefit may be higher, interest rates go down, we have seen them change 1 percent, 2 percent, 1 percent over six months, 2 percent over a year, they can easily turn that around.

THE COURT: Isn't it the GATT rate in effect at year end?

THE WITNESS: It is in effect at year end, but it only applies to people that actually both leave and take a benefit

within the next year.

THE COURT: Right. But I mean for that population, you're certain as of January 1st as to how you would calculate their frozen accrued benefit for the remainder of the calendar year. Am I right?

THE WITNESS: That is true.

THE COURT: It is not fluctuating, for instance, like LIBOR, not going up and down and all around?

THE WITNESS: Some places it changes more often, but most are annual. I have seen some quarterly, but most of them are annual. To me, it is not the place. An SPD is supposed to, in my mind, supposed to provide a summary, general information, giving people a good idea what the plan is about.

To tell someone that, well, here is what the effect would be this year, then you almost have to go on and say what it might be in future years and then it creates a level, I think a level of confusion. Well, what does that mean for me and how do my numbers work out.

The best way to deal with any of that is on an individual level when someone is serious about leaving, okay, I am going to leave this year, I need an estimate. Of course, you give an estimate. Now you know what the estimate is for the current year. You lock in the rates.

You still have to warn them. If you don't leave and leave in a subsequent year, that number we gave you could

change, and then you could explain to them when you're sitting down with them that, okay, here's how it works and you can have that one-on-one discussion and maybe get a little better understanding.

Once you give someone a number, in my experience, it just sticks with them. You can caveat it to death, and they remember where -- we are numbers people, we remember numbers. Oh, $37,500. Next year they see it is 31,000. I told you it was going to go down. No, you didn't.

THE COURT: Thank you.

MR. RACHAL: John, could you pull up PX-5, that is the summary plan description for the retirement plan. Would you view Page 12. If you can, there is a section on additional account balances.

BY MR. RACHAL:

Q. Let me ask you first on this section, is this going to apply to everyone who is given this SPD?

A. No. It would only apply to people who were around before December 31st of '95, having accrued benefits at that point.

Q. For the folks in this initial account balance section applied to, would you look at the bottom, your accrued benefit, and then blow it up if you could. Your accrued benefit at the time your employee terminates is the greater of the amount determined under the plan, accrued benefit plan as amended on January 1, 1996 or your accrued benefit as of December 31,

1995. Is that the greater of provision you referred to earlier?
A. Yes.
Q. How do you interpret that provision?
A. I interpret it that you go through the calculations under the new plan, which is essentially the cash balance benefit, where that would provide -- that is the plan as amended, so I interpret that. Then you check to see as a final step whether the calculation, accrued benefits as of December 31, 1995 was, you know, was only under the prior plan, that is clearly what you're referring to. If that is greater, the person gets that benefit. That is how I read it.
Q. What about the fact that the accrued benefit, your accrued benefit at the time your employment terminates, is the italicized term, does that impact your analysis here?
A. You know, after Mr. Deutsch's testimony, I went back and read this for the 5th or 6th or 7th time. I think that, you know, the language here is not as elegant as maybe it could have been in terms of tying it all together.
I view this as you've got a basic definition in the front which applies to most or many situations including for new employees. Then you've got this sort of special provision here that is telling you, you know, look, this is what we mean by accrued benefit for all the stuff that we have been talking about on this page here, and it either -- I don't know if I

would say it modifies it or -- you know, it grows out from the definition.

I don't view it as an inconsistency and, therefore, an excuse to drop that whole language at the end, I think that language at the end, whatever put there, unless you put some intended meeting that you have.

Q. When you referred to the language at the end, what are you referring to?

A. The greater of, and it is including your accrued benefit as of December 31, 1995.

MR. RACHAL: Can you put up Page 14, the example of the SPD, PX-5.

BY MR. RACHAL:

Q. You recall Mr. Deutsch's opining on this example?

A. Yes.

Q. Does this example state whether it is illustrative?

A. Yes. It starts off saying the following chart shows how this participant's account balance will accumulate.

Q. Go to the bottom of the page. Is that what you were referring to?

A. Yes. To me, this table was very simply intended to just show how an account with some given opening balance of $7,000, doesn't get, doesn't get into how was that calculated, how old was the person, when are they going to terminate or any of that.

All it does, here is what the opening balance is. How does your account grow from year-to-year. You have an interest credit on that opening balance in the first year, you've got a pay credit, you've a balance at the end of the year and it brings that balance over. It shows after three years you have a cash balance of 9676. It doesn't talk about you can terminate or any of that stuff. It is just meant to be an illustration. I have seen something like this in a lot of cash balance SPDs. It is kind of Cash Balance 101. Here is how your account balance works.

Q. Does this illustration also contain a greater of notification --

MR. GOTTESDIENER: Objection.

Q. -- statement?

THE COURT: I'll allow it.

A. Remember this now, these is focusing on development of the account balance. It talks about below all this, these calculations, it has interest credits and opposition credits continue to be determined as indicated above for each year of service and so forth at the end. It says lump sum payable to you is greater than your account balance or the amount determined under federal law and IRS regulations.

It doesn't have quite the same language referencing the accrued benefit, but I don't know that I would have expected it to in that this is really an illustration of how

the account balance works. It is sort of a new benefit under the plan, the cash balance benefit. It is not trying to, as Page 12 was trying to do, sort of wrap it all up and tie in the 12-31-95 benefit.

Q. What we were talking about earlier, did the whipsaw aspect of the plan cause the benefits to be greater than the account balance?

A. Yes, and that whipsaw, of course, would apply to this type of calculation. So when you're done here, the individual left and had an account balance of 9676, and interest rates were low enough, you have to go through a special calculation that is under the plan and determine under federal law and IRS regulations. I would have read that to encompass in this place, I would envision that encompasses whipsaw, that is what was intended here.

MR. RACHAL: Pull back up the first of DX 405.

BY MR. RACHAL:

Q. So now I am moving onto Topic 4, which is whether there was volatility of interest rates made the cash balance account the only certain lump sum benefit.

It is correct, Mr. Sher, you had analyzed the 30-year treasury rates previously used for 417 (e) before Congress changed its corporate bond rate?

A. Yes.

MR. RACHAL: Go ahead and pull up DX 416.

BY MR. RACHAL:
Q. Is that showing your analysis of the 30-year treasury rates during this period?
A. Yes, this looks very similar to the chart I saw before.
Q. Did you consider these higher rates showing here, the average over, for example, 15-year period, and you can see the chart in the treasury bond rates are pretty high there to be historical anomalies?
A. I think it is difficult to pinpoint any period of time and characterize it as an anomaly. I think people who live through it, and I being one of them, remember, remember what the environment was like and again people felt like that's the way the world was going to be.
Yes, there were some things going on in the economy that caused all of that, but there are always things going on in the economy that cause things.
So I think it is history. It happened. I wouldn't characterize it as an anomaly. I don't see why.
Q. Is it correct you didn't have any certain view as to what the rates of, start with, say at the time of the conversion, 1-1-96 as to the future movement, direction of interest rates, whether they're going to go up or go down?
A. I think again maybe my personal sense and a lot of people I knew and respected felt it was more likely that rates would go up and down, say, reach 6 percent. Many economists would say

that rates at any point in time, rates are just as likely to go up as go down. You have to sort of take that for what it is worth.
Q. Did you review the 30-year treasury rates post-conversion?
A. Yes.
Q. What did it show on volatility post-conversion?
A. Well, the rates continued to be extremely volatile. Once we got into '96, the rates jumped up within six months by a percent. Then they leveled off a little bit and started coming back down some, but were higher at the end of the year by half a percent than they were at the beginning of the year.
MR. RACHAL: Would you pull up DX 417.
BY MR. RACHAL:
Q. Does this graphic illustrate the monthly 30-year treasury rates in 1996?
A. Yes, it does.
Q. And that is what you were talking about where it went from 6 percent to a little over 7 percent in the first several months of 1996?
A. Yes.
MR. RACHAL: Pull up DX 418.
BY MR. RACHAL:
Q. What does this slide show about the 30-year treasury rates post-conversion?
A. Well, for the most part with some little blips, exceptions

here and there, they headed down quite a bit.

By the time you got to 1999, they were quite a bit lower. Then we start seeing volatility again, there they go back up quite a bit, it looks like a percent or more than a percent, close to 2 percent over the course of a couple of years there. Then they start to level back, trending downward.

Q. Do you recall what the 30-year treasury rates did after 2002 as a general trend?

A. I think they trended still somewhat even more downward than what they were at this point. They got into certainly the 4s.

Q. Do you recall earlier when I was talking about Mr. Deutsch's analysis on the 401 (h) ratio between change in the interest rate and the change in the protected lump sum benefit?

A. Yes.

Q. What was your opinion on Deutsch's analysis on that point?

A. Well, I think it was fine in terms of he was looking at the 30-year old, and I didn't see anything wrong with it.

Q. Did you review Mr. Osberg's protected benefit post-conversion?

A. Yes.

MR. RACHAL: Would you pull up DX 419.

BY MR. RACHAL:

Q. What did your analysis show of Mr. Osberg's benefit post-conversion, at the time of the conversion to the time he

took his benefit in 2002 show?

A. Just to explain what is on here a little bit, the purple line is meant to, meant to show what the present value of that benefit would have been if the rates had remained at 6.06 percent, which is the rate in 1996. It is just meant to sort of show the trend line.

As the person ages, there is one less year of interest discount to age 65, so you're going to see this value go continuously upward.

The green line shows the same point, the same place at the beginning of '96 because it was also based on 6.06 percent at that point in time, but it now shows the annual changes, where that present value, that protected benefit actually was at various points in time beginning with each year specifically all the way up until the very end which was the distribution date which was October 1st of 2002 when Mr. Osberg received his lump sum.

(Continued on next page)

Q. If you look at the graphic that we are showing, the 417(e) rate, and it shows by year, 6.06, 6.5, 5 percent and so forth, that is what you talked about earlier, how the 417(e) rate is locked in for one year based on the prior December, is that correct?
A. That's correct.
Q. But each year it varies depending on what the prior December rate was, correct?
A. Correct.
Q. What does it show happened to Mr. Osberg's protected lump sum benefit between, I think it's 1999 and 2000?
Let me give a backup question. What happened to the 417(e) rate between 1999 and 2000?
A. OK. In 1999, the 417(e) rate was 5.06 percent, and in 2000 it went up to 6.35 percent. So about a 1.3 percent increase.
Q. What happened to the value of Mr. Osberg's protected lump sum benefit with that change in the rates?
A. OK. It decreased by 25 percent from 23,000 to about 17,000.
Q. So if we were to have told Mr. Osberg his protected lump sum benefit in 1999, we would have been telling him that he could expect about 23,000?
A. Actually, we would have told him he would expect 23,000 plus interest on it, you know, at about the 6 -- you know, 5 percent at least, 6 percent, 5 or 6 percent. So that benefit

would have even grown a little bit further like the way you see this trend line growing, the purple line.

So this decrease of 25 percent actually has embedded in it and is softened because of about a 6 percent increase. So if it hadn't been for that natural increase, it would have decreased by over 30 percent.

Q. What benefit would Mr. Osberg receive had he terminated and taken a distribution in 2000?

A. I believe he would have, his frozen accrued benefit was, looking at that $17,600 number, we would have to compare it to his account, but I think it was still it was above -- I think it was still somewhat above his account balance at that time. It was getting fairly close, but it would be $17,605.

MR. RACHAL: Jon, go ahead and pull up DX 420.

BY MR. RACHAL:

Q. What is different between this slide and the slide we discussed earlier, Mr. Sher?

A. This slide is a hypothetical. It takes Mr. Osberg and shows what the impact would have been had he or somebody like him was age 30 rather than his actual age, which I think was 41 or 42, which was intended to essentially sync up with Mr. Deutsch's age 30 numbers to show what the impact would be on a younger person, and you can see the impact would be even greater.

Q. So why was it that the impact of the change on interest

rates in the protected lump sum benefit is larger at age 30 versus I think Mr. Osberg was in his mid 40s?
A. It is just more years for the differential in interest rates to operate. Instead of, you know, starting at age 40 to age 65, you are starting at age 30. So, another 11 years of that differential between the two interest rates causes, on a compound basis causes an even greater increase or decrease when the rates change.
Q. Using the hypothetical Mr. Osberg, about 15 years younger, what does it do to the change in his benefit, protected lump sum benefit? We are going to assume he's in wear-away here between 1999 and 2000.
A. It is now showing a 35 percent decrease.
Q. Based on your experience as an actuary, would a 35 percent decrease in a person's expected retirement benefit be problematic?
MR. GOTTESDIENER: Objection.
THE COURT: Why don't you rephrase.
Q. In advising companies does variation in the retirement benefit such as this, showing the up-and-down nature of retirement benefits expected for participants, cause HR problems for the companies you advise?
MR. GOTTESDIENER: Objection.
MR. RACHAL: Human resources problems I mean. HR.
THE COURT: Hold on. Let me just read this.

THE COURT: Why don't we do it a little differently, which is, what impact, if any, do you think or do you know it may have to describe retirement benefits that include this up-down interest rate volatility?

THE WITNESS: Well, I think that this is a problem in terms of employee, you know, in terms of employee communication. And if someone was planning on leaving -- and obviously this person is very young, but maybe they were planning on leaving and taking a lump sum and they thought the benefit was going to be $12,980 and it could be, shortly thereafter it becomes $8440, and it's because that is the way the government rules work, that is an issue that the HR people are very uncomfortable with.

And for that reason, we were talking earlier about lump sums being provided under traditional plans where they jump all over the place not being nearly as common as they are in a cash balance plan. That's why for the most part. It's these ups and downs.

And then you start having to sort of figure that out, you know, you don't know where rates are going to go. You can't figure it out. That's the problem with this, all this volatility -- we talk about expectation and using some type of projection, but what projection? What's the right answer? I don't know what the right answer is.

THE COURT: All right.

THE WITNESS: So that's really -- it's a dilemma.

THE COURT: Why don't we take our midafternoon break here.

Is this a good time?

MR. RACHAL: Yes, your Honor. This is a great time.

THE COURT: All right. Let's take our mid afternoon break. We'll come back in 10 minutes.

(Recess)

THE COURT: Mr. Rachal, you can proceed.

MR. GOTTESDIENER: Your Honor, just real quick. Can I hand up to the Court PX 1394A. This concerns the Court's inquiry as to the percentage of folks who didn't need the amendment. They received a lump sum as the de minimus cashout.

THE COURT: Correct.

MR. GOTTESDIENER: This is a paragraph of Mr. Deutsch's rebuttal that we had deleted because it was mainly in the context of rebutting Dr. Niden's report, but the parties have agreed to bring this paragraph in to be responsive to the Court's request for data as to how many folks were in the de minimus lump sum category.

The denominator the Court has up there is, from data that was available, 15,000 folks, and I don't have it in front of me but the result is about 43 percent.

THE COURT: OK. Thank you very much.

MR. GOTTESDIENER: The way we have numbered it, your

Honor, is we just put an A, that's the number of Mr. Deutsch's report. So in the event your Honor has marked up your copy, you don't have to replace it.

THE COURT: All right. Thank you.

BY MR. RACHAL:

Q. Mr. Sher, do you recall testimony that Foot Locker had benefit registers run estimated protected lump sum amounts for everyone for 1996?

A. Yes, at least for part of, I remember something through June and maybe there was another one, but I do remember that discussion.

Q. Would these registers or these estimates be accurate beyond the year in question, 1996?

A. My understanding from the testimony is that those registers were calculations, I think by individuals of their frozen protected benefits in 19 -- I think it was 1996, in that year, so they all would have reflected the 6.06 percent rate, but that they were only intended to be used for that year.

Q. Is the problem with trying to use those estimates beyond that year what is reflected in DX 420, the graphic?

A. Well, yes. I mean, if you look at the 7,407 number at the beginning of '96, as soon as you move forward to January 1 of '97 when the rate went up to 6.55, you see that there is a 13 percent decrease due to that change.

Q. Do you recall seeing these concerns about the changes in

the protected lump sum benefit going back to participants being discussed in Foot Locker?

A. Yes, again, I believe it was -- I think it was in, it might have been Mr. Kiley's testimony when I -- I know I was here for that, when there was I think an e-mail chain where that discussion, there was some discussion in there.

MR. RACHAL: Jon, could you pull up PX 164.

This is an e-mail chain. Go --

Q. Is this the e-mail chain you were recalling?

MR. RACHAL: I'm sorry. Let's go back to the first page.

THE COURT: What is the opinion that you want from him on this? Because I don't want him to just march through the record. We have been over these documents.

MR. RACHAL: I think there was a little bit of confusion as to what is being referred to, at least from an actuary's point of view.

He can tell you this is what I think they are doing, and he's got a pretty good basis for it, at least I would contend.

It would show what is going on here from an actuarial point of view as to why they were expressing these concerns.

That's all, your Honor.

THE COURT: All right.

BY MR. RACHAL:

Q. Is this the e-mail you recall?
A. Yes, that's right. This is very familiar.
Q. Go ahead and go to the last -- the first e-mail actually in the chain. It is a chain of e-mails. I think it's dated 6/13/96. We would like to see the figures should he decide to retire 6/1/97 and 6/1/98.
A. I see that, yes.
Q. And at least for someone who was or could be in wear-away, what's the problem with giving them figures for one and two years past 1996?
A. It looks like it was pretty well a year and two years after June of '96. Well, for the '97 one you can have a change in interest rates, likely to have it as of the beginning of the year, and then possibly another or likely another one at the beginning of 1998. That could change the calculations considerably.
MR. RACHAL: Jon, go to the first page of the e-mail. I think it's the third paragraph down if you would.
That one. Would you blow it up.
BY MR. RACHAL:
Q. Can you see that e-mail up there, Mr. Sher?
A. Yes.
Q. It says, As we cannot determine the rate of interest in successive years, it is virtually impossible to produce a projection that has any value. We currently are seeing a rate

swing of over a full point in this year alone.

You see the date of the e-mail? It is dated June of 1996, correct?

A. Yes.

Q. What rate had changed over a full point as of June 1996?

A. The 30-year treasury rate changed by a point.

Q. All right.

A. Over a full point. It's about a point.

Q. If the current monthly rate holds to the end of the year, benefit calculations will be significantly impacted in 1997.

What do you understand Ms. Kanowicz to be referring to there?

A. The rate's already gone up by 1 percent. You know, there is no assurance that that rate in June, absolutely no assurance that that rate in June is going to hold up until the end of the year and be effective in the following year. Basically I think she's saying that we are seeing the kind of volatility we have, and it's, you know, that pattern may very well continue. We don't know where it's going.

Q. And those 1 percent rate, change in rates would cause the 20 or 30 percent change in the value of the lump sum protected benefit, depending on someone's age?

A. We would have to -- at the age of this person, it would be significant. Even for someone age 65 it would have some significance, but even for someone younger it would have

increasingly more significance.

THE COURT: Let's take the 1996 time frame for a moment, and let's assume that there is going to be a 1 percent swing.

In terms of what you know about the average amount of wear-away, not in real dollars, but in percentage terms for those participants affected, would a 1 percent interest rate swing have eliminated wear-away, or would the lump sum benefit nevertheless have been greater than the cash account balance?

Do you understand what I am saying?

THE WITNESS: I would say that it depends. For people with enhancements, it could very well -- and I've seen examples, several, where the rate went up enough during '96 just a half a percent, it swung them over to the other side where they are out of wear-away completely.

For others, all it's going to do is bring them closer to getting out of wear-away.

But what it's doing is, nevertheless it's just changing the amount of benefit that they would be entitled to if they left, even if it's not going below the account.

THE COURT: But you could have a situation, where, for instance, their initial account balance is determined at or was determined in part with respect to a 9 percent discount rate, right?

THE WITNESS: Yes.

THE COURT: And then the lump sum at the GATT rate, the beginning of '96 might be 6.06 or it might be 5.95 or 7.87, which was it going to be? Was it going to go down or up?

THE WITNESS: From when to when?

THE COURT: '96 to '97.

What's the 1 percent swing?

THE WITNESS: It was going up. During '96 it went up 1 percent from January to June.

THE COURT: Is that the seven point --

THE WITNESS: 7.06.

THE COURT: 7.06. So it goes up a percent. There's still almost a two percent difference, so a 1.8 percent difference between the 9 percent and the 7.1 or 2, right?

THE WITNESS: Yes.

In '96, there's very little pay credits added, yeah.

So at that point in time, you're right. The differential may be, for someone who does not have an enhancement they will still not be out of wear-away, but their frozen protected benefit has changed in value.

THE COURT: But it's likely still above their initial account balance?

THE WITNESS: It's likely that it's still for people without enhancements, at least people with longer service. People with shorter service, their pay credits could start adding up and meaning something, although it's still 1996, so I

doubt it.

THE COURT: For those people in wear-away in 1996, did the majority receive an enhancement or the minority receive an enhancement?

THE WITNESS: I would say a minority. There were about 2,000 people who, class members who received enhancements. And, of course, most of them -- they were all over age 50. There was a tendency for them to, for many of them to leave in '96 and '97, proportionately maybe even more so than people who did not have enhancements. But, I mean, it's 2,000 out of 16,000. That's about 12 or 13 percent, one-eighth, thereabouts.

THE COURT: OK. Thank you.

THE WITNESS: You're welcome.

BY MR. RACHAL:

Q. Can we turn to the SPD for just a few minutes, Mr. Sher. Is it correct that you testified that you did not see SPDs discuss wear-away in any detail.

Is that correct?

A. Yes. I would say that's correct.

Q. I want to focus not on the survey but on the clients that you advised in the '80s and '90s I guess in cash balance conversions. Did some of those clients use opening balances that had wear-away or the risk of wear-away?

A. I would say virtually all of them had the risk of

wear-away, and some of them had some initial wear-away.

Q. Did any of those SPDs, those balance, cash balances conversions that you reviewed, did any of them discuss wear-away?

A. I don't recall. I don't think so. I don't recall any of them doing that, no.

Q. For the employers that you were advising, did they have mixes, employees educated? Uneducated? What type of employees did they have?

MR. GOTTESDIENER: I'm sorry. I am going to object. I thought we did this testimony before.

THE COURT: I will allow it. I was the one asking the questions.

In light of that, if Mr. Rachal wants to ask questions, I will allow it.

MR. GOTTESDIENER: OK.

BY MR. RACHAL:

Q. Go ahead.

A. I would say that many of these are very large companies, and they have the full gamut of employee types, from executives and senior management, middle management, clerical people, sales staff. A lot of the companies had a pretty diverse workforce is the way I would describe it.

Q. I am going to move on to another topic now.

I just want to be clear on the terminology we are

going to be using, because it will impact our further discussion.

Your understanding, what is an A plus B benefit, assuming that the prior annuity benefit is now offered as a lump sum.

A. I would say that the A benefit is the frozen accrued benefit as of the date of conversion. That may be payable in any of the forms, including, if they had a lump sum, whether they had it before or they added it at the conversion. It would therefore include a lump sum form, early retirement benefits, whatever was associated with that accrued benefit, at least before, and then whatever is added into it, like a lump sum.

Q. When in an A-plus-B benefit, assuming they take it as a lump sum, when is that A benefit valued?

A. If they are taking a lump sum, the A benefit would be valued, it would -- invariably at the date that the lump sum distribution is taken.

Q. Not the date of conversion, the date of distribution?

A. No.

Q. What does B represent in this A plus B scenario?

A. B are the pay credits and interest credits. So it's, the account balance is derived from the pay and interest credits after the conversion date.

Q. Does the A-plus-B benefit, or construction eliminate any

wear-away for the lump sums?
A. Yes.
Q. Is this A plus B type of benefit the remedy that was awarded in *Amara v. Cigna*?
A. That's definitely my understanding.
Q. OK. Is it correct that under the Foot Locker cash balance plan at date of conversion, that there were at least some group of participants who didn't, who had -- excuse me, let me just state it more accurately -- who had an account balance that was larger than the protected lump sum benefit?
A. Yes. There were some who did initially, not a lot, but some who did initially, because of the enhancements.
Q. Do you recall about how many there were?
A. Mr. Deutsch I think said there were about 200 of them, and I think that that's about the number that I got.
Q. Did the 417(e) rate rise between 1996 and 1997?
A. Yes.
Q. Did that rise in the 417(e) rate ultimately impact the number of participants who had no wear-away on the lump sum benefit?
MR. GOTTESDIENER: Objection.
A. With the rise in --
THE COURT: Hold on.
THE WITNESS: I'm sorry.
THE COURT: Sustained.

Why don't you reask it.

BY MR. RACHAL:

Q. Did the rise in the 417(e) rate result in participants having no wear-away effect on the lump sum benefit when they took distribution?

MR. GOTTESDIENER: Objection.

THE COURT: Hold on.

Why don't you do it this way:

What impact did the rise in the 417(e) rate have on different segments of participants?

Why don't you describe that.

THE WITNESS: OK.

I think, for people who had enhancements, who took lump sums in 1997, there were many of them, I think it was about 400 of them, who ended up receiving a lump sum distribution that was both larger than the present value of the accrued benefit, but also larger than the present value of the accrued benefit, plus the pay and interest credits, in other words, larger than how I'm defining an A plus B.

Q. Did you analyze any of these participants to see what happened with their benefits postconversion?

A. Yes, I did.

Q. And was participant -- I am going to call him 04 -- one you analyzed in depth?

A. Yes. This is ID, we'll call it ID 04.

Q. Did you do a similar analysis for class member Sue Hartmann?
A. Yes.
MR. RACHAL: Jon, pull up I guess I'll start with DX 421.
BY MR. RACHAL:
Q. Does this graphic represent your analysis of 04's benefit?
A. Yes, it does.
Q. What does the blue line represent?
A. OK. The blue line is the account balance, the actual account balance. Now I should point out that we see a little notch that's in there. It really should, ideally it would have been better if you just showed this as a smooth line. It wouldn't have that little step in it at the very beginning of 1997.
Also, these other lines that are slanted down, which I will get to I am sure in a few minutes, the A plus B, the orange line and the green line would have been virtually vertical, because all we are doing is changing by one day. We are crossing over from December 31 to January 1, but the only way to really illustrate it without having visual problems was to show a little bit of a slant, a little bit of a notch for that one day. So that one day has been magnified.
Q. Does the change between December 31, 1996 and January 1, 1997 impact the value of the account balance?

A. No. The account balance just keeps going up steadily.
Q. So what does the green line represent in this graphic?
A. The green line is the present value of the frozen protected benefit.
Q. And what does the -- I am going to call it the yellow line -- represent?
A. The yellow line is what I have described as the A plus B. It's the present value of the frozen protected benefits. It's the green line plus the pay and interest credits added on top of that.
Q. And when did participant 04 take his distribution?
A. As it indicates, he or she -- I don't know which it is -- took their distribution at November 1, 1997.
Q. What did you conclude based on when 04 took his or her distribution?
A. Well, we can see that the highest line here is the blue line, which is the account balance of 132,572. This person had an enhancement, I think.
Is there a footnote?
Q. Yes. It's noted.
A. I wasn't sure if everybody had that. What happened to this person is the account balance now exceeds not only the green line, which is the present value of the frozen benefit, but also the summation of the, what I characterize as the A benefit, plus the B benefit, which is 127,406.

Q. Does 04, participant 04, illustrate the distinction between being in wear-away and the wear-away effect?
A. I think it does.
I would characterize it, as if somebody's in wear-away that means that their frozen protected benefit exceeds their cash balance account. A wear-away effect can continue after somebody gets out of wear-away depending upon the relationship between the A-plus-B benefit and their account. But if their account is greater than the A-plus-B benefit that means that their account has given them enough to cover their full value of their accrued benefit, plus the pay and interest credits.
Q. So when was 04, I guess, in wear-away?
A. 04 was in wear-away during 1996. We see that the green line is above the blue line until we hit January 1, 1997, when the green line drops down because of the higher interest rate, and the blue line just keeps going off the way it was going. So on January 1, this individual was out of wear-away.
Q. Is it correct that in fact 04 had no wear-away effect because of that drop in interest rates?
A. That's what I would characterize it as. The person had no wear-away effect.
Q. Have you ever seen this type of analysis attempted to be explained to participants?
A. I don't know that I have seen any of that attempted to explain it quite in this way. I have seen examples of, again,

individuals, you know, when there is an individual discussion with these concepts being discussed, although I am not sure that they get into multi-year discussions.

Usually they just talk about, you know, here's what it is now, and it's subject to change because this green line, this green line can jump up and down as interest rates go down or up.

Q. Did you conduct a similar analysis for the class member Sue Hartmann?

A. Yes.

MR. RACHAL: Jon, if you would pull up DX 425.

BY MR. RACHAL:

Q. Real quickly, what are the blue and the green lines here?

A. Well, again the blue line is the account balance and the green line is the present value of her frozen protected benefit. This is all now within one year, 1996, because she received a distribution on November 1 of '96.

Q. So what happened with Ms. Hartman vis-a-vis wear-away during 1996?

A. She began the year where her account balance which, which also included an enhancement, was less than the present value of the frozen benefit, the frozen protected benefit. Then sometime during '96 when she started to receive pay and interest credits, she got to the point where it -- the actual account balance would have exceeded the present value of the

frozen benefit. And then by the time she left, you know, her account balance was $31,600 versus the present value frozen benefit of $30,937, so she received the account balance.

THE COURT: It would have been just pay credits she received, right, because the interest is a look back? Or the cash account balance?

THE WITNESS: That's right.

I don't think there would have been any interest on the pay credits because you're still in the year. You do not earn interest until the following year.

THE COURT: But she would have received the pay credit on a quarterly basis, is that right?

THE WITNESS: I think that's right.

THE COURT: All right.

MR. RACHAL: Jon, go ahead and pull up DX 426.

This may also speak to this a little bit.

BY MR. RACHAL:

Q. What was added to this slide?

A. What was added to this slide were the pay credits. So above the green line you can see as the year goes on they start off the same because there are no pay credits as of the beginning of the year, but as the year went on you have a yellow line, which is now an A plus B. It is a sum of the benefits.

Q. Is it accurate that Ms. Hartman was out of wear-away when

she took the distribution, but she had a wear-away effect?
A. That's the way I would characterize it. So she had, the difference between the $33,429 and what she received $31,600 was a wear-away effect. So she received a portion of her pay credits, which you can see here is the difference between the other two numbers, the lower two numbers.
Q. Then under the A-plus-B remedy Ms. Hartmann would receive the sums that would gross her up to $33,429?
A. That's how I would apply that type of remedy, correct.
MR. RACHAL: Would you pull up DX 427.
BY MR. RACHAL:
Q. What does this slide show now?
A. This slide is -- it is a hypothetical, that if she decided to delay her distribution, her lump sum for I guess it's two months -- she received it in November, so if she decided to delay it until January or sometime early next year, but this is calculated as of January 1, we can see the effect on both the green line and therefore the yellow line of the increase in interest rate from, you see at the top 6.06 to 6.55 right at the beginning of 1997.
Q. Is it correct that, had she waited two months, she would have had no wear-away effect?
A. If she waited two months, yes, she would have had the wear-away effect.
Q. She would have had or would not have had?

A. I'm sorry. She would not have had the wear-away effect because the account balance, the blue line, would now be above the green line.

Q. This is an example of someone going from having some impact to wear-away to not having impact to wear-away based on the change -- under the hypothetical, based on the change in interest rates between 1996 and 1997?

A. Yes. And just to add to that, the A-plus-B amount would now be $30,959, lower than the account balance.

So, to me, what that would mean is that, just by virtue of the interest rate change in 417(e), as of that January 1, she would not only be out of wear-away but would have no wear-away effect. In other words, the 31,877 would have been exceeded the present value of her frozen benefit plus the pay credits.

So, you know, while she could say, earlier I think she did say in testimony that she had, she didn't get all of her pay credits, I don't think she can say that if she had taken her distribution two months later.

Q. Were participant ID 04 and Ms. Hartmann anomalies?

A. I wouldn't characterize them as anomalies.

I mean, if the people who had the enhancements and went out in 1997, I think were likely to have an effect like this. All of them probably not, but a good number of them would have, and I think I determined there were about 400

people that were in this very similar situation.

Q. What about the whipsaw feature that you discussed earlier. Did that have any impact on whether people had a wear-away effect?

A. The whipsaw feature is only going to apply when interest rates get low enough, so it doesn't apply in these examples that we have been looking at so far.

But when we get to some of the years when the interest rates get down to five and a half percent or lower, then what happens is you still have all this volatility from changes in interest rates in terms of the total benefit that someone may be entitled to, but the wear-away, the cash balance benefit would get, account would get grossed up for the lower interest rates in addition to the frozen protected benefit.

Q. Did you determine how many participants fell in the category that the whipsaw had the effect of eliminating any wear-away effect?

A. At some point I did. I don't know that I did it in my reports, but there were a good number of them.

Q. Did you come up with a conclusion as to how many people had an account balance that they were paid lump sum distribution account balance that was larger than what would be an A-plus-B benefit?

A. I think it was 900 -- about 950.

Q. With Mercer's help could Foot Locker have accurately

forecast those like 04 Ms. Hartmann who went in and out of wear-away postconversion?

A. When you say accurately forecast, I mean, they would have had to have had some type of crystal ball to do it. I mean, in hindsight it's easy to see what happened, but if you are sitting there trying to make a projection, no one single projection is going to tell the story.

Q. Is it correct that you could make a reliable prediction for the year in question, but you couldn't predict for the following year?

A. For the year in question, because you know what the rates are, you can certainly make a good estimate. You may not know exactly what the person's compensation is, but you can usually get pretty close and calculate their benefits.

Sometimes the compensation may not matter. If they are in wear-away, it would just be a matter of recalculating the frozen accrued benefit as a date sometime later in the same year.

MR. RACHAL: Pull up DX 419.

BY MR. RACHAL:

Q. Mr. Osberg. From your review, was Mr. Osberg more on the higher end of those who had been subject to wear-away?

THE COURT: In terms of duration?

MR. RACHAL: Yes. I'm sorry. Correct.

A. I would say yes, that his situation, he had a good amount

of service, and he was into his 40s. I would say the answer to that is yes.

Q. What about estimating wear-away for those who had this larger spread between the account balance and the protected benefit like Mr. Osberg. What about predicting that wear-away?

A. You might be able to predict that they will be still in wear-away with a fair amount of reliability knowing that interest rates would have to increase very dramatically, you know, over a short period, given they don't have an enhancement, but that still leaves you the problem that the benefit itself, the value of the frozen protected benefit could change very much.

So if the idea is to try to predict how the value of their frozen benefit, which is what they -- a person like that would end up receiving in all likelihood, you really can't do that.

Q. Is it correct for somebody like Mr. Osberg you could do a probability analysis of what the length or duration of the wear-away may be under different interest rate scenarios?

A. I suppose you could do some type of an analysis. My preference would be to do something, not to try to predict probabilities, but just to show what it might be under different scenarios.

I think it still would be confusing, which is the right scenario, you know, and -- what does it mean? Well, it

shows your benefit is going to jump all over the place. I have no idea what it's going to be.

Q. Is it fair to say you couldn't predict with any certainty, though, whether you could estimate the duration of wear-away?

A. Yes. For the same reason, you would have no way. Not only you couldn't estimate the duration, but that you go in and out of wear-away is something. Maybe not for somebody like Mr. Osberg, who will take a longer period to get that cash balance account up closer to their value of the protected benefit, but as time goes on, that's going to become an issue, too, going in and out of wear-away.

Q. What about the amount of Mr. Osberg's benefit? Is it fair to say that you really can't predict what the amount of his protected benefit would be without knowing what the interest rate is going to be in subsequent years?

A. That's correct.

Q. Did you've conduct any analysis of what would have happened with the protected lump sum benefit had the 30-year treasury rates reverted to their recent historical averages?

A. Yes, I did.

Q. What did you call that analysis?

A. What I called it was a mirror-image analysis, where if you look at the next, you know, I think it was 16 years after the conversion, we know what actually happened, but the scenario is, what if the rates reverted to what they were in the last 16

years?

And I did it on what I call a mirror-image basis, which is, rather than starting off with the first year's rate being the rate in effect 16 years prior to 1996, I did it in reverse order.

I said, let's take the first year, I would take the difference in the interest rate and work my way backwards, the difference in the interest rate between one year, you know, at 1/1996 and 1995, and then I would move forward with that difference and I would work my way backwards in time and create a mirror image.

MR. RACHAL: Jon, could you go ahead and pull up DX 428.

BY MR. RACHAL:

Q. Is this the mirror-image analysis you were describing?

A. Yes.

Q. If you would, just go ahead and tell us what the three different lines, the blue, the red, and the green line represent?

A. OK. So this is for someone who is age 40. It's, you know, a hypothetical, somebody who was age 40 with a $10,000 accrued benefit payable at age 65.

And the blue line represents the -- you see the opening balance. It was around 9,300, something like that.

And it shows, you know, how the account balance would

change over time. And this is actually just the opening account balance.

None of these lines here have any pay credits in it. The analysis is just intended to focus on the difference between the opening account balance with interest and the present value of the frozen benefit.

So neither of those have any pay credits, none of these lines have any pay credits in them. So the account balance just grows by 6 percent every year. It doesn't matter what the interest rate scenario is, it's always going to grow by 6 percent a year.

Q. What does that line represent?

A. Do you want to start with maybe the green line.

Q. I'm sorry. Let's go ahead and start with the green line.

A. The green line, you see the interest rates above, which are in green, the actual 30-year treasury. I have rounded these, just for simplicity, to I think the nearest half a percent. So 6 percent was the 1996 rate, 6.56, and so forth.

Those are the rounded actual rates in all of the years going out 16 years to starting in '96, so it would be 2002 -- I'm sorry, 2012, which you can see on the bottom.

All right. So that represents -- the green line represents the present value of the frozen accrued value.

MR. RACHAL: Jon?

Technical difficulty.

MR. GOTTESDIENER: That's proof that they are now out of wear-away.

THE WITNESS: Could be.

THE COURT: I have had a few wear-away jokes over the last week.

MR. RACHAL: It is not up.

THE COURT: I have the slide here.

THE WITNESS: We can talk from this.

MR. RACHAL: There we are. OK. We have it.

BY MR. RACHAL:

Q. Go ahead. I'm sorry.

A. So the green line is just the present value of the frozen protected benefit at those various interest rates. Again, these are the rounded actual rates.

We can see that we are coming down the first year, going up for two years. The same pattern we were looking at before. It just takes it on further than what we looked at for anyone before, all the way up to 2012.

You can see those very low rates and high values as we get into more recent years.

The red line is you can see the rates up top, so in the first year it goes from 6 to 8. Now why 8? Because 8 was the rate at the beginning of 1995.

And 6.5 was the rate at the beginning of 1994.

And the next year, 1993.

So working our way backwards 16 years from 1996 takes us back to around 1980. The 10 percent rate that you see at the end here is the actual rate rounded, I believe it was in 1980 if I did my arithmetic correctly.

What it shows is that if the rates had reverted in that mirror image that the line would generally be much lower.

Why?

Because the rates in the past were higher. As you can see, the red line is always below the green line. It's because you can see the rates, the historical rates going backwards in time were always higher. And in fact 16 years, 1980, it was 10 percent.

So what this shows is that there would have been, if the rates had -- you know, everybody says, well, look, the rates have come down. Why are you discussing this?

The reason I'm discussing it is because when we're sitting there in 1996, you know, we didn't know where the rates were going to go. The rates could have reverted back to a more similar pattern that was historical. If they had, then we would have had very little of wear-away effect, because the difference between the blue line and the red line is the wear-away effect.

Remember the pay credits are not included in either line, in any of these lines. And then, in fact, it would have dipped below the blue line at, you know, towards the end of the

period.

That's what this illustrates. It is just that it's easy to, you know, Monday morning quarterback all this and say, look, rates have gone up. Of course, by virtue of the rates going up that meant that the value of the protected benefit went up, and it meant anybody affected by it was getting a higher lump sum than they might have gotten had interest rates gone up rather than gone down.

MR. GOTTESDIENER: I think you meant --

THE WITNESS: Did I goof that up?

MR. GOTTESDIENER: I think you meant down.

THE WITNESS: Yes, I've got it confused.

It's getting later in the day I guess.

MR. RACHAL: Yes.

THE WITNESS: Right. Rates have gone down, which caused the green line to go up, as compared to the red line where it has higher rates.

And while there's less, much less wear-away effect with the red line with the higher rates, the present value of the frozen protected benefits are a lot higher when the green line, when the rates have gone down, and, you know, if that applied, if indeed the person was still in wear-away effect, at least they got the, in addition to getting the cash balance account as a floor, as a guarantee, they would have received the benefit of the increase in the value of the reduced

interest rates.
Q. Under your analysis here, Mr. Sher, you used the 30-year treasury rates for both actual and historical, correct?
A. Yes.
Q. Is it correct that -- you've already done it -- congress later raised the 417(e) rate to the corporate bond rate, correct?
A. Yes.
Q. What would have happened to this analysis, how would it modify your analysis if you applied the corporate bond rates to these periods?
A. OK. Just by way of approximation, if you take the difference of the corporate rates over a 30-year bond rates and accept that it's close to one and a half percent, what would happen is, because the rates would all be higher by one and a half percent, both the green line and the red line would go down kind of in parallel to where they are.
And the red line would cross probably, either entirely or almost entirely the blue line, especially in some of these later years, even more so than it already does in the later years. And the green line would also come down and be very close to, maybe not quite crossing the blue line, but being much closer to it.
Q. Regarding the protected lump sum benefit, I am talking about in the Foot Locker plan, is it correct that you saw the

value of that protected lump sum benefit increase substantially for participants when the 417(e) rate rose?
A. Can you repeat that? I am not sure I got it.
Q. Let me make sure I stay close to the mic, too.
Regarding the protected lump sums, is it correct that you saw the value of the protected benefit decrease substantially for participants when the 417(e) rate rose?
A. When the 417(e) rate rose, the value of the protected benefit came down.
Q. Was Mr. Osberg an example?
A. Mr. Osberg -- well, by the time Mr. Osberg left, the 417(e) rate had come down, thereby raising the value of the protected benefit.
Q. But during the period between conversion and distributions --
A. Yes. There were times, I think twice during that period where there was an increase in the rate, which brought the protected, the value of the protected benefit down during that period, yes.
Q. For account balances, did you ever see the account balance decrease for anyone?
A. No, it shouldn't. It should always increase.
Q. Was anyone ever due less than his account balance plus postconversion pay and interest credits?
A. No.

Q. From your perspective as an actuary, was there a certain reliable benefit provided by the cash balance plan?
A. Well, the cash balance benefit, as we've seen in these illustrations, was very predictable, reliable, you know, you knew how it would grow for interest.
You could certainly estimate the pay credits for someone pretty closely. It just depends on their pay and their service, which was predictable.
Q. How do you view the protected lump sum benefit?
A. It's certainly a benefit that the plan by law has to provide. But in terms of the amount of the benefit, it's variable, you could say contingent on what interest rates happened to be at the time. It's not reliable or predictable.
MR. RACHAL: Can I have one second, your Honor.
THE COURT: Yes.
MR. RACHAL: Jon, if you would go back and pull up DX 405. Now we are going to move to a topic 5, which is whether an A-plus-B reformation remedies lost pay and interest credits.
BY MR. RACHAL:
Q. Again, to refresh, for lump sums in an A-plus-B benefit, how is the A benefit calculated?
A. Present value using 417(e) rates of the frozen protected benefit.
Q. At what time?
A. At the time of distribution.

Q. And, unless somebody was I think 70 or above, is it correct that they would have to terminate employment to be able to elect a lump sum distribution?
A. Yes.
Q. Does this A-plus-B benefit preclude any wear-away for lump sums?
A. Yes.
Q. How does it do that?
A. Well, the frozen protected benefit by definition is what the person had earned under the pre-1996 plan. And by paying a lump sum equal to the present value, under 417(e) of that frozen protected benefit, that is exactly the value of that benefit.

And then you would add on to that the pay and interest credits under the plan so the person automatically would be receiving the sum of their, what they had prior to the amendment, and the pay and interest credits under the cash balance formula.

MR. RACHAL: Jon go ahead and pull up DX 429.

BY MR. RACHAL:
Q. Regarding wear-away in an A-plus-B benefit, what does this slide show?
A. Well, it shows the A -- the A-plus-B benefit is in the middle yellow column. It's the sum of the protected -- the present value 417(e) basis of the protected benefit, the

116,948 and the sum of the pay and interest credits. This is again for participant ID 4.

So, it shows -- though it's hard to see I don't know why -- the sum that is $127,405. It's very light on the -- lightly above that bar.

And then so that is the A-plus-B benefit as I have defined it.

And lump sum actually received there is $132,572 total. What I have done, which you can see, is higher than the A plus B benefit, which we have seen before for this participant. All this does is split up the opening balance between what I am characterizing as a basic opening balancing, which is before reflecting the enhancement of $73,269, and this would include interest at the 6 percent rate between the period January 1, 1996 and November 1, 1997.

And the enhancement is in this case 67 percent, the maximum enhancement this person was entitled to of the -- of the basic opening balance, so the enhancement was $48,846, again with interest.

And there are the pay credits that were added to the account along the way, so the total ended up at 132,572, about $5,000 more than the A-plus-B benefit.

Q. Why was there no wear-away for a participant 04?

A. Well, there's no wear-away -- two reasons. The enhancement, number one, it is a very important reason. And

the other one is remember, you will recall before that we showed that the part A benefit, the 116,948 in the middle. That frozen protected benefit came down in value as a result of the change in interest rates from 6.06 to 6.55 at the beginning of 1997.

Q. What happens with mortality under the A-plus-B approach?

A. The part A benefit reflects a mortality in its calculation, but only future mortality from the time of November 1, 1997, going forward from that point in time. So it does reflect mortality both in the preretirement period and in the postretirement period.

Q. Is it correct that it is reflecting mortality not until date of conversion but until date of distribution?

A. Yes. The fact that the person has lived until this point in time for the almost two years, it would only reflect mortality from that date, the November 1997 date forward.

Q. Under 417(e), what does this mortality discount to payment reflect?

A. It reflects the probability that the individual will die at various points in time both prior to age 65, when the annuity would start. It's converting into a lump sum and for the rest of the person's life there is a probability each year that the person will die.

Q. Earlier we had talked about actuarial equivalents, and what you are converting in this is an annuity that begins at age 65,

correct?
A. Yes.
Q. And you are getting a certain payment at whatever age -- I don't know what the age was, he or she was. So is it reflecting the risk that someone may die between this, before they would receive their annuity, the preretirement mortality aspects of it would get them to age 65?
A. Yes, it reflects mortality at all ages. It wouldn't even have gotten to the first annuity payment.
Q. Is mortality discount required in your view to make an annuity payable at age 65 equivalent to a lump sum payable at let's say 45?
A. I think it's the appropriate way to make the calculation.
Q. Did you analyze what the remedies would be classwide under an A-plus-B approach?
A. Yes I did. I think it was in my -- I think it was in my rebuttal report.
Q. Do you recall the numbers or do you --
A. I think we ought to look at them.
MR. RACHAL: If you would, go ahead, Jon, and pull up, I think it's DX 401, the Sher rebuttal report. I think it's around paragraph 81 that's where it starts. Would you go ahead and pull up the table, too, I believe under that.
Thank you.
BY MR. RACHAL:

Q. So is this your analysis of an A-plus-B benefit, at least in part?
A. Yes, it is.
Q. Does this reflect the A-plus-B benefit just for those who took lump sums or received lump sum distributions?
A. Yes.
Q. And you valued them I think, because that's when the expert reports were done, you were valuing as of what time period? You had data through when? Do you recall?
A. I think it was either January 1, 2011 or January 1, 2012.
Q. That time sounds about right.

What did you conclude the A-plus-B remedy would be for lump sums before prejudgment interest?
A. It looks like it was 20.8 million.
Q. Does that reflect interest under the plan until date of distribution, the 6 percent interest credits?
A. Yes, everything is calculated as of the various individual distribution dates.
Q. But that doesn't reflect any post-- excuse me, prejudgment interest after the distribution, correct?
A. The 20.8 million does not, correct.
Q. Do you recall about what you quantified what the A-plus-B remedy would be for those in annuity or who hadn't taken distributions? You might want to look at your report.
A. It looks like my estimate was about two and a half million

dollars.
Q. So that would be on top of the 21 million, correct?
A. Right, yes.
Q. Did you do an estimate of what the remedy would be if the prior subsidized -- excuse me. Strike that. Did you do an estimate of what the remedy would be if the prior 30-year treasury rate was replaced with the corporate bond rate?
A. Yes. I -- I believe I did a, an estimate at seven and a half percent interest.
Q. And that would have been the corporate bond rate at the time of conversion?
A. Approximately, yes.
Q. What did you conclude in that estimate?
How would that change the numbers, the lump sums?
A. I believe it would reduce the 20.8 million to about 14 million. That's in paragraph 84.
Q. Are there any qualifications you have to that estimate for the corporate bond rate, the seven and a half percent rate?
A. Well, I used the seven and a half percent, which was the rate at the time, approximately the rate at the time.
What I think would be a better approach would be to use the, if we are going to use corporate bonds, to actually use the corporate bond, the actual corporate bond rates as amended and introduced in Section 417(e) by Congress in 2006, those so-called segment rates, which would reflect the actual

rates in effect at the time that each person took a distribution.

Q. And those rates overall have, like the 30-year treasury rate have decreased since 19 -- excuse me, yes, since 1997.

A. For the most part that's correct.

Q. The seven and a half percent that you're using as a -- I will call it a spot rate here, since the rates have overall declined -- would that increase your number slightly?

A. Yes, somewhat. That would increase it somewhat.

MR. RACHAL: If you would pull up DX 411, the class letter.

Q. If you assume that there is a remedy appropriate to -- if you assume a remedy is appropriate to remedy wear-away, what does this slide show you?

A. Well, in terms of the people who are -- who went out in '96 through '98, they didn't really have a chance to, because they left so soon, they didn't have very much in the way of pay credits.

They might have had as much as three years for those who went out late in '98 and as little as $20, like Lorie Lerew. It varied, but, you know, it would be anywhere from virtually zero to three years of pay credits, and that's the most they could have lost. At the very least everybody the part A benefit, and some people got more than that and, you know, as we've seen in the examples, particularly the people

with enhancements, they already got their enhancements, so they would -- to get up to an A plus B, they may not need anything more.

Q. For all of those folks, their wear-away would have at least been capped when they terminated employment, they would no longer be experiencing wear-away. Is that accurate?

A. That is right.

Q. During this period, the 417(e) rate that was being applied was the 30-year treasury rate, correct --

A. Correct.

Q. -- to calculate the protected lump sum?

A. That's correct.

Q. In your view, is that a correct rate or a subsidized rate to convert annuities into lump sums?

A. Well, it was required by law, but, again, just because it was required by law doesn't mean that it wasn't subsidized. And I think -- my view even before Congress made the change was that the 30-year bond rate is a subsidized rate.

Q. Is it fair to say that participants, the class members who cashed out their lump sums during this period were able to change their annuities that they acquired under the prior plan into a favorable interest rate?

A. I would say they were, yes.

Q. Did you review Mr. Deutsch's damages analysis?

A. Yes.

Q. In Section 4.B of his opening report?
A. Yes, I did.
Q. Did Mr. Deutsch do what you considered an A-plus-B analysis of damages?
A. He did a version of an A plus B, what I would consider an A-plus-B analysis, yes.
Q. Did Mr. Deutsch calculate the value, in this section 4.B of his report, did Mr. Deutsch calculate the value of the protected benefit based on 417(e) rate in effect when the participant terminated?
A. In his Section 4.B I think, yes, I think he did.
Q. And in his Section 4.B analysis, I think it was called like a lost pay credit analysis, did Mr. Deutsch include a discount for preretirement mortality?
A. I believe he did in that section, yes.
Q. Do you agree with all aspects of Mr. Deutsch's analysis in that section 4.B?
A. No.
Q. What parts don't you agree with?
A. Well, the part that I don't understand, don't agree with, is Mr. Deutsch treating under an A-plus-B analysis, where there are no opening balances, adding in an enhancement onto an opening balance.
I can't see how one can add an enhancement on an opening balance when the A plus B doesn't have an opening

balance.

He treated it as a pay credit. It is not a pay credit under the plan. He just added it in.

Q. Do you recall about how much that adding in the enhancement caused the variance between Mr. Deutsch's numbers and your numbers on an A-plus-B approach?

A. I believe it was about $20 million.

Q. Was there any other major differences you had between you and Mr. Deutsch how you calculated the A-plus-B benefit?

A. I think there was a whipsaw that Mr. Deutsch added on to his part B benefit, a whipsaw calculation, whereas I didn't because I felt, first of all, whipsaw is no longer required, no longer provided under the plan. And if the point is to provide a true A-plus-B benefit, I don't think employees -- the whole concept of whipsaw is not something that employees generally understood that they were, might be entitled to. It's something that at one point was required by the IRS, but I mean, I don't see -- I don't have an expectation of receiving whipsaw.

Q. Do you recall about how much whipsaw, that the dollar amount of that whipsaw cost between you and Mr. Deutsch's A-plus-B analysis?

A. I think it was something like 3 or 4 million dollars.

Q. Did you use a class member to illustrate the difference between you and Mr. Deutsch on how you calculated an A-plus-B

benefit?
A. Yes.
Q. Was that 04 again?
A. I believe it was, yes.
MR. RACHAL: Can you pull up DX 429.
Q. I think this time we will go more into -- tell me what the green bar consists of?
A. All right. The green bar, again, on the left is the lump sum that he actually received, which was his basic opening account balance with the enhancement added on to it with interest and the pay credits, equaling $132,572. That's what he received.
Q. The yellow bar, again what is that?
A. That I characterized as A plus B, the present value frozen accrued benefit, the interest and mortality at the time, the distribution November 1, 1997, plus the sum, part B, the sum of the pay and interest credits.
Q. Is it correct that 04 did not experience any wear-away as of his date of distribution?
A. That's correct.
Q. What does the blue bar show?
A. The blue bar shows what I understand from Mr. Deutsch's section 4.B is the way he would determine that type of remedy.
Q. How did he get there?
A. Well, the two of us start off the same.

The part A benefit is the $116,948.

The pay credits are $10,457.

Because this is in 1997, there is no whipsaw effect for this person, because the interest rates were, you know, were not below six or five and a half percent or so.

So, so far we are in sync. And then what Mr. Deutsch did is he took those same enhancement that was over here -- what he would do, as I understand it, is he would take the same enhancement that's over here on the left that he already received, the $132,572, and then add it on top of this A plus B as a so-called pay credit.

Q. Did you see that enhancement described as a pay credit in any plan communications?

A. In I saw it in Mr. Deutsch's report. Any plan communications?

Q. Plan communications?

A. Yes.

Q. How was the enhancement described in plan communications? Do you recall?

A. I think it was described as for the people who were over age 50, with 15 years of service as an add-on, an adjustment to their opening account balance at 9 percent.

Q. Was the formula actually tied to the initial account balance to create the enhancement?

A. It was a percentage of that 9 percent initial account

balance.

MR. RACHAL: Your Honor, do you want to break now?

I can keep going.

THE COURT: If you've got more --

MR. RACHAL: I have probably about an hour and a half and a half. That is my best guess.

THE COURT: That is fine.

We had previewed yesterday when you folks were off, probably getting ready for today, that you might take some time to Monday to complete the direct.

So why don't we go ahead and break. You can just go back to your other table and step down for the day.

Let's just talk about logistics and talk about whether you folks have conferred about whether you would like to have closing arguments, what you think is equitable in the situation, time, etc.

Did you folks have a chance to talk?

MR. GOTTESDIENER: We did.

MR. RUMELD: You can go first.

MR. GOTTESDIENER: You can stand up, too.

MR. RUMELD: I have been sitting for so long today.

MR. RACHAL: I have been standing. I'm glad to sit.

Thank you, your Honor.

THE COURT: All right.

MR. GOTTESDIENER: Mr. Sher's not yet done with his

direct. It's conceivable that -- I would hope we would be all done by lunch.

MR. RACHAL: My best estimate is an hour, an hour and a half. I feel pretty good about that.

THE COURT: Let's just say 10:30-ish. Then you would have a maximum of two hours. So then we would be done just before lunch including the break.

MR. RACHAL: I may have a little redirect. It just depends.

THE COURT: You might have a little redirect, right.

You've got plenty of time. The question is, do you want to do something Monday afternoon, which we would have then time for, or would you be prepared to take some time?

There are pros and cons. Getting it over with is a big pro. And we power on through. What do you folks think?

MR. RUMELD: I am amenable to either solution.

MR. GOTTESDIENER: So am I, your Honor. Whatever is best for your Honor.

THE COURT: If you folks want to use that time in the afternoon, that's totally fine with me. From my perspective, getting it done is useful, because it's all in my head at the same time.

But if you folks want a couple of days, we can try to work out another time, but I would want to do it within a couple of days.

MR. GOTTESDIENER: Does your Honor have a couple of hours open a couple of days after Monday?

THE COURT: Not really, but I could find time. I could maybe swap some things around.

I've got a bench trial starting, as I told you folks, on Tuesday. That is going to take all day.

We have a full day Tuesday. We are better off Monday. Because it looks like somebody has filled up my calendar on Tuesday. I have a trial starting on Tuesday.

So I am going to have to find a spot for some of that stuff already before I slot you folks in.

Can you do it Monday?

MR. RUMELD: I can do it Monday.

MR. GOTTESDIENER: Yes, your Honor.

THE COURT: All right.

MR. RUMELD: If it is OK with the Court, I think I would like to have and understanding that if we get done a little before lunchtime we start after lunchtime, just so we can regroup during the lunch break.

THE COURT: Yes. You will want to regroup, talk to people about anything that may have come up. But basically, it sounds like we are into the damages piece and so we are at that phase. So I think it's limited.

we have been through the bulk of it.

Right, Mr. Rachal?

MR. RACHAL: Yes, your Honor.

THE COURT: How much time do you folks think you need. We have three hours Monday afternoon, I would say two hours and 50 minutes to be fair, because we have to take a ten minute break, somewhere in there.

So two to five with a ten-minute break. I am happy to sit that entire time.

MR. RUMELD: That works for me.

THE COURT: Do you want like a little under an hour and a half apiece then, right?

MR. GOTTESDIENER: I would reserve --

THE COURT: Hour and ten minutes apiece?

MR. GOTTESDIENER: I would reserve some of my -- I would go first.

THE COURT: You haven't been very good about reserving time. You can reserve, but I will leave it up to you to stop.

MR. GOTTESDIENER: Right.

THE COURT: I am not going to cut you off. If you will use all your time, you will use all your time.

MR. GOTTESDIENER: He will pull on my suit jacket.

THE COURT: However you arrange it.

MR. GOTTESDIENER: Yes.

THE COURT: Let's do that.

We will take the two hours and change, and we'll split it evenly.

All right. Thank you, folks. I will see you Monday morning at 9 a.m.

I do have a full calendar tomorrow Joe is reminding me. I need you to push things down. I only need from the first table over.

MR. RUMELD: I had one another question.

THE COURT: Go for it.

MR. RUMELD: Your Honor I think had asked for a pared down Carol Kanowicz video. Should we arrange --

THE COURT: I don't need it to really be pared down physically, because I can find on the videotape what I need to find.

I just was wondering whether you wanted to direct me by page and line -- you don't even have to direct me by minute or hour. If there are things in particular you want to make sure I don't miss because just don't want to have to watch four hours after having already read her designations.

MR. RUMELD: I wasn't sure whether your Honor was expecting it, or should we just make sure it is done by the close of the case?

THE COURT: Actually, if you guys could send in a letter tomorrow, short, just one line.

MR. GOTTESDIENER: That is what we were we planning.

THE COURT: That would be terrific, because I could finish watching it own over the weekend.

If it's in the beginning, if it is in the first half, I've already seen it. If it's in the second half, I'm trying to cut it short.

Then you also were going to do the revised exhibit list, so we can get those into the record, Mr. Huang?

MR. HUANG: I think would be for Monday.

THE COURT: All right. Terrific.

MR. HUANG: I think we just submitted video for Thomson and Flesses, too.

THE COURT: Now that I know that you folks include everything, how long do those folks go on?

I will look at some in the beginning to see how he is and who he is at the beginning. Then it's two or three hours. I will want to skip after some introductory bit when I get a feel for him to what's important.

I have also already read his written designations his transcript designations.

MR. HUANG: It is about two hours each for Thomson and Flesses. The letter will include that.

MR. GOTTESDIENER: In the letter we would target --

THE COURT: Terrific.

I will look at, again, other parts of it as well that you folks have designated, just again to get a feel for the witness, but it would be helpful to be pointed in the right direction.

All right. That's it from my perspective.

Anything else from you folks? No?

All right. I'll see you Monday morning at 9. Thank you.

MR. GOTTESDIENER: Thank you, your Honor.

(Adjourned to Monday, July 27, 2015, at 9:00 a.m.)

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